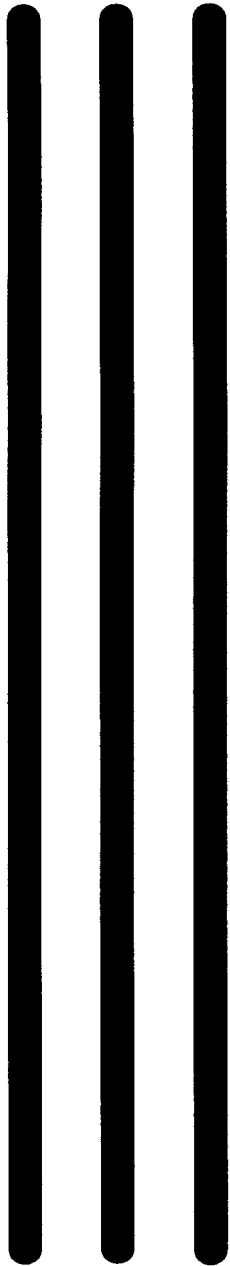




**U. S. Department of Agriculture  
Office of Inspector General  
Audit Report**

**Risk Management Agency  
Nursery Crop Insurance Program  
Crop-Years 1995 Through 1996**



**Audit Report No.  
05099-2-At  
DECEMBER 1998**

**UNITED STATES DEPARTMENT OF AGRICULTURE**

**OFFICE OF INSPECTOR GENERAL**

**Washington D.C. 20250**



DATE: December 16, 1998

REPLY TO  
ATTN OF: 05099-2-At

SUBJECT: Nursery Crop Insurance Program

TO: Kenneth D. Ackerman  
Administrator  
Risk Management Agency

ATTN: Garland Westmoreland  
Deputy Administrator  
Risk Compliance

This report presents the results of our audit of the Risk Management Agency's administration of the Nursery Crop Insurance Program. Your November 12, 1998, response to the draft report is included as exhibit C with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant sections of the report.

We concur with your management decisions for Recommendations Nos. 1c, 3, 5b, 7, 8, and 9. We can accept management decisions for Recommendations Nos. 1a, 1b, 2a, 2b, 4a, 4b, 5a, 6a, 6b, and 6c once you have provided the additional information and assurances as outlined in the report sections OIG Position. Your responses to a number of the recommendations did not include the timeframes for implementation of the proposed actions. Such timeframes are required by Departmental Regulation 1720-1.

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 on all findings and recommendations within a maximum of 6 months from report issuance. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

We appreciate the cooperation and assistance provided by your staff during the audit.

JAMES R. EBBITT  
Assistant Inspector General  
for Audit

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# TABLE OF CONTENTS

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<b>CHAPTER 1 - EXECUTIVE SUMMARY .....</b>	<b>1</b>
<b>Results in Brief .....</b>	<b>1</b>
<b>Key Recommendations .....</b>	<b>2</b>
<b>Agency Position .....</b>	<b>3</b>
<hr/>	
<b>CHAPTER 2 - INTRODUCTION .....</b>	<b>4</b>
<b>Background .....</b>	<b>4</b>
<b>Objectives .....</b>	<b>5</b>
<b>Scope .....</b>	<b>5</b>
<b>Methodology .....</b>	<b>7</b>
<hr/>	
<b>CHAPTER 3 - SALES AND SERVICING ACTIVITIES WERE NOT ADEQUATE .....</b>	<b>8</b>
<b>FINDING NO. 1 - REINSURED COMPANY DID NOT VERIFY THE REASONABLENESS OF PRODUCER INVENTORY .....</b>	<b>8</b>
<b>FINDING NO. 2 - PRODUCER WAS INDEMNIFIED FOR UNINSURED INVENTORY .....</b>	<b>11</b>
<b>FINDING NO. 3 - REINSURED COMPANY USED CROP VALUES FOR ESTIMATED GROWTH--NOT ACTUAL .....</b>	<b>13</b>
<b>CHAPTER 4 - LOSS ADJUSTMENT ACTIVITIES WERE NOT PROPERLY PERFORMED .....</b>	<b>16</b>
<b>[ .....</b>	<b>]</b>
<b>FINDING NO. 5 - QUESTIONABLE LOSS ADJUSTMENT ACTIVITIES CONTINUED IN 1997 .....</b>	<b>23</b>

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CHAPTER 5	FINDING NO. 6 - RMA's SYSTEM FOR IDENTIFYING AND SANCTIONING PRODUCERS WITH ABNORMAL LOSS HISTORIES WAS NOT EFFECTIVE .....	26
CHAPTER 6 -	MANAGEMENT OF THE NURSERY CROP INSURANCE PROGRAM BY RMA AND THE REINSURED COMPANIES WAS INADEQUATE .....	32
	FINDING NO. 7 - RMA DID NOT TAKE CORRECTIVE ACTION TO ADDRESS IDENTIFIED PROBLEMS .....	32
	FINDING NO. 8 - REINSURED COMPANY QC REVIEWS WERE DEFICIENT .....	34
	FINDING NO. 9 - PROPOSED CHANGES FURTHER WEAKEN THE NURSERY CROP INSURANCE PROGRAM .....	35
	FINDING NO. 10 - RMA OVERSIGHT OF LARGE LOSS CLAIMS NEEDS IMPROVEMENT .....	37
<hr/>		
CHAPTER 7 -	EXHIBIT A - SUMMARY OF MONETARY RESULTS .....	40
	EXHIBIT B - LOCATIONS VISITED .....	41
	EXHIBIT C - RMA's RESPONSE TO THE DRAFT REPORT .....	42
<hr/>		
CHAPTER 8 -	ABBREVIATIONS .....	50

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## CHAPTER 1 - EXECUTIVE SUMMARY

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### *Results in Brief*

The Risk Management Agency (RMA) and the reinsured companies need to improve their management and administration of the Nursery Crop Insurance Program. The program has been abused by sales agents, loss adjusters, and producers. We reviewed five producers' loss claims for 1995 through 1996 which totaled about \$6.2 million, or 27 percent, of the indemnities paid nationally to nursery producers. Significant problems were identified for three of the five producers, resulting in questionable indemnities totaling \$3,472,182 and underpaid premiums of \$3,149,166.

We found that reinsured companies' sales agents did not assess the reasonableness of producer reported inventory values, and loss adjusters did not verify the reported causes of loss. One producer, who received over \$2.9 million in indemnities, submitted inflated values for inventory to the reinsured company. As an example, this producer was indemnified for one group of 10,000 damaged plants insured for \$15 each--this same size and type of plant was available locally for \$7.50 each.

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We found that RMA's system for identifying and sanctioning producers with abnormal loss histories was not effective. As a result, producers having a history of receiving large, recurring indemnities have been allowed to continue to purchase insurance coverage at the same premium levels as producers with little or no loss experience. For example, one producer received indemnities each year from 1993 through 1996 totaling over \$2.8 million which should have resulted in premium increases in 1997 and 1998. However, the producer underpaid premiums by about \$3.1 million for crop-years 1997 and 1998

because various similar name combinations were entered into the RMA computer system, thereby circumventing procedures for identifying producers with abnormal loss histories.

Although the reinsured companies performed quality control (QC) reviews for each of the claims we reviewed, the QC reviews did not identify deficiencies similar to those disclosed in our audit. In addition, the agency did not provide adequate oversight and monitoring of the program which could have prevented the improper indemnities and the underpaid premiums.

Because of producers' and insurance companies' questionable activities which resulted in improper indemnities and underpaid premiums, we provided information concerning the applicable producers and insurance companies to the Office of Inspector General (OIG), Investigations, for their consideration and further review.

During performance of this audit, RMA staff from the Risk Compliance Division, who had experience in the crop insurance program for nurseries, provided technical and other, as needed, assistance to the auditors.

**Key  
Recommendations**

We recommend that RMA develop a plan to ensure that reinsured companies comply with program regulations in their management of the Nursery Crop Insurance Program. In addition, we recommend that RMA (a) revise the current system of monitoring crop insurance activities to include more direct involvement by RMA, (b) adjust the cited producer's premium for crop-year 1999, and (c) as appropriate, recover from the reinsured company that portion of the questionable indemnities totaling over \$2.9 million, including the \$286,992 that was paid for uninsured inventory.

Finally, we recommend that RMA coordinate with OIG-Investigations to [

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***Agency Position***

In its November 12, 1998, written response to the draft report, RMA expressed general agreement with the report's findings and recommendations. For those recommendations requiring recovery of questionable indemnities, RMA withheld agreement to recover the funds until they have had the opportunity to review the supporting workpapers.

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## CHAPTER 2 - INTRODUCTION

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### Background

RMA was authorized by the Federal Agriculture Improvement and Reform (FAIR) Act of 1996, Public Law 104-127. The FAIR Act established RMA as an independent agency of the U.S. Department of Agriculture (USDA) to manage the Federal Crop Insurance Corporation (FCIC) and to provide oversight over all USDA insurance programs. The FCIC is a wholly-owned Government corporation that publishes insurance regulations and manages the Federal crop insurance fund.

All insurance is provided through private reinsured companies which administer policies they sell. The reinsured companies are compensated for administrative, operating, and claims adjustment expenses--31 percent of net booked premiums for 1995 through 1996, for the buyup and standard multiple peril crop insurance (MPCI) programs. They also receive compensation for loss adjustment expenses associated with catastrophic risk protection (CAT) policies.

Crop insurance is offered only to wholesale nursery operations growing plants which meet the requirements outlined in the nursery crop provisions. Nurseries are insured for unavoidable damage caused by adverse weather conditions, fire, insects, plant disease, wildfire, earthquake, volcanic eruption, failure of the irrigation water supply, and/or frost or freeze, which occur within the insurance period.

CAT coverage is available to producers for a nominal annual fee of \$50 for each crop. CAT protection compensates producers for losses which exceed 50 percent of the producer's average yield at 60 percent of the established maximum price. Additional insurance coverage may be purchased which provides for greater levels of protection against crop losses than the level of coverage offered under CAT. If a producer chooses to purchase additional coverage, he/she can choose to insure at a level of up to 75 percent or 90 percent of the wholesale market value of his/her inventory. In 1995, the basis used was the value of the producer's average monthly inventory, and in 1996, the basis changed to the value of the producer's highest monthly inventory.

When additional insurance is purchased, catastrophic coverage is automatically included. The cost of additional insurance is partially covered by a Federal subsidy. Under the FAIR Act, FCIC is required to use private reinsured companies to deliver both MPCI and CAT policies. In crop-year 1997 and earlier, CAT



coverage could be obtained from the Farm Service Agency (FSA) county offices; however, beginning in crop-year 1998, CAT coverage can only be obtained from reinsured companies.

### **Objectives**

The overall objective of this audit was to determine if RMA has ensured the integrity of the Nursery Crop Insurance Program. Specific objectives were to determine (a) the propriety of indemnities paid to nursery producers and (b) if reinsured companies were complying with RMA policies and procedures.

### **Scope**

This audit was performed in accordance with generally accepted government auditing standards and primarily covered indemnities paid in Florida for 1995 and 1996 crop-year losses. Indemnity payments in Florida for nursery losses during the 2 years totaled about \$22 million which represented over 95 percent of all nursery indemnities (\$23.2 million) paid nationally.

We reviewed indemnities totaling more than \$6 million paid to five producers for nursery losses occurring in crop-years 1995 and 1996. The five producers were judgmentally selected for review based on their having received large indemnities in 1995. The producers received over 35 percent (\$5,405,459) of indemnities totaling \$15,179,583 paid for nurseries in 1995. (See table 1.)

<b>FLORIDA PRODUCER REVIEWED</b>	<b>CROP- YEAR</b>	<b>INDEMNITY</b>
<b>A</b>	<b>1995</b>	<b>\$ 611,730</b>
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
<b>C</b>	<b>1995</b>	<b>101,365</b>
<b>D</b>	<b>1995</b>	<b>2,944,872</b>
<b>E</b>	<b>1995</b>	<b>1,463,483</b>
<b>E</b>	<b>1996</b>	<b>612,233</b>
<b>Producer Totals</b>	<b>1995</b>	<b>\$ 5,405,459</b>
	<b>1996</b>	<b>\$ 855,534</b>
<b>Florida Totals</b>	<b>1995</b>	<b>\$14,969,963</b>
	<b>1996</b>	<b>\$ 7,018,925</b>
<b>National Totals</b>	<b>1995</b>	<b>\$15,179,583</b>
	<b>1996</b>	<b>\$ 8,045,632</b>

**TABLE 1**

Based on information collected during our review of crop-years 1995 and 1996 regarding questionable loss claim inspections, additional policies and losses were reviewed for the five initial and two added producers for crop-years 1994, 1997, and 1998.

We performed fieldwork at reinsured company offices, the RMA Headquarters, compliance and regional service offices, and at other locations as necessary. (See exhibit B.)

We made referrals to OIG-Investigations regarding possible criminal violations by (a) producers who may have intentionally took action to evade RMA's system for identifying those producers with a history of abnormal losses, (b) producers who may have reported incorrect information used to determine loss claims, and (c) insurance companies who may have approved improper indemnities.

## **Methodology**

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

- Review of applicable Federal laws and regulations and RMA and FCIC policies and procedures.
- Review of prior audits and other examinations and analyses performed by OIG, RMA, the General Accounting Office, FSA, and the Office of the General Counsel (OGC).
- Interviews with officials of RMA, FSA, FCIC, OGC, and private reinsured companies.
- Interviews with officials of the Florida Department of Agriculture and county extension offices.
- Interviews with nursery producers, horticulture experts, and industry recognized nursery technical experts.
- Tests of loss adjusters' indemnity determinations.
- Interviews with loss adjusters and insurance sales agents.
- Site visits to producers' nursery operations and review of their records and practices.
- Interviews with National Weather Service and National Oceanic and Atmospheric Administration officials and review of their respective data.

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### CHAPTER 3

## SALES AND SERVICING ACTIVITIES WERE NOT ADEQUATE

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Reinsured companies did not properly verify inventory values used to establish crop insurance liability. The companies accepted values that were inflated by the producers and that were based on later growth stages of the crop rather than the actual growth stage. One company also paid indemnities on inventory that had not been insured. Improper inventory values occurred partly because RMA instructions were not specific regarding verification requirements.

As a result of the improper inventory values, insurance premiums and guarantees were incorrectly computed. We identified one producer who received questionable indemnities totaling \$2,944,872 for crop-year 1995.

Inflated inventory values cause the premium amounts paid by the producer and the Government to be improperly increased. Increased premiums will, in turn, cause the Government to be overcharged for reinsured company administrative expenses, which are reimbursed by the Government. This also improperly allows the reinsured company to retain a portion of premiums not earned.

The standard reinsurance agreement (SRA) states, "Any amounts paid \* \* \* to the [reinsured] company which are later determined to have been improperly paid because of failure to follow FCIC approved policies or procedures will be repaid to FCIC."

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***Finding No. 1  
Reinsured Company  
Did Not Verify the  
Reasonableness of  
Producer Inventory***

We found that reinsured companies did not always verify the reasonableness of producers' inventories.

The SRA requires reinsured company sales agents to verify inventory value and quantity when determining a producer's premium and guarantee.<sup>1</sup> To purchase crop insurance coverage, producers must submit an annual inventory summary which includes, among other things, the wholesale price of the plant (which must be reasonable).<sup>2</sup> The inventory summary will be used to determine premiums and the amount of insurance.<sup>3</sup> Moreover, the SRA states that "the company<sup>4</sup> must verify all yields and other information used to establish insurance guarantees."

For example, one reinsured company provided coverage to a producer who had overvalued his inventory. Producer D

operated a nursery on 2.5 acres. He reported an annual inventory of about 670,000 plants with an estimated insured value of \$3.1 million. This producer reported inventory plant values greater than wholesale prices listed in industry publications. The producer reported the higher values because he claimed that he sold his plants to markets in Europe and the Caribbean region. However, the producer was not able to provide us with evidence of actual sales at the higher prices. We concluded that indemnities totaling over \$2.9 million were paid to producer D in crop-year 1995 for inflated inventory values.

Two plant types represented the majority of the insured's indemnified inventory for crop-year 1995.

- The producer insured 10,000 kentia palms in 6-inch containers for \$15 each. Wholesale industry price data showed kentia palms in 6-inch containers<sup>5</sup> were available for purchase at \$7.50 each. The producer's records showed he did not sell any 6-inch kentias in 1995, but he did sell 8-inch kentias for \$2 each.

Kentia palms represented \$1.9 million of the producer's \$3.1 million insured inventory. Moreover, damaged or destroyed kentia palms represented \$2.2 million of the \$2.9 million in indemnities the producer received for crop-year 1995. (See table 2.)

- The producer insured areca palms in 4-inch containers for \$4 each. Producer D's records showed he did not sell any 4-inch plants of this plant type in 1995; however, he did sell the larger 6-inch size for \$1 each.

The local county extension agent advised us that he was familiar with producer D's nursery. He stated that, at best, the producer's inventory value could not have been greater than \$500,000. Using the \$500,000 inventory value, the maximum indemnity that the producer could have received would have been \$337,500.

We found that neither the sales agent nor the adjuster verified the reasonableness of inventory values when determining insurance coverage and performing preacceptance inspections. The reinsured company's compliance manager told us that inventory plant prices should be assessed prior to attachment. However, both the sales agent and adjuster stated that it was neither their responsibility nor practice to evaluate the reasonableness of inventory plant prices submitted for coverage.

RMA instructions were not specific regarding the need to verify the reasonableness of inventory values. FCIC's Nursery Handbook states that the adjuster is responsible for determining that the insured has complied with all provisions of the insurance contract.<sup>6</sup> FCIC Nursery Crop Provisions, which are part of the

insurance contract, state that the producer's wholesale price list may be examined to determine if the prices listed are reasonable.<sup>7</sup>

Details concerning a second case where inventory values were overstated are provided in Finding No. 3.

**Recommendation  
No. 1a**

Recover from the reinsured company that portion of the \$2,944,872 paid to producer D that was improper because of inflated inventory values.

**RMA Response**

In its November 12, 1998, response, RMA deferred agreement to recover the funds until such time that the Raleigh Compliance Field Office (RCFO) has completed a review of the workpapers.

**OIG Position**

To accept management decision for this recommendation, we need the details and applicable timeframes for recovery from the reinsured company of the cited questionable indemnity.

**Recommendation  
No. 1b**

Revise instructions to clarify responsibility for verifying the reasonableness of inventory values for sales and loss adjustment purposes.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied

*The Federal Crop Insurance Corporation (FCIC) introduced an entirely new nursery policy for the 1999 crop year, which began on October 1, 1998. As part of this new program, it will issue an Underwriting Guide and a Loss Adjustment Manual, as well as various forms, including new inspection forms. The Underwriting Guide provides specific instructions for such inspections.*

*In addition, the structure of the new policy reduces the vulnerability of the program to losses based on the reported values. Growers' prices are no longer used. Rather, FCIC has published a list of prices to be used when working losses.*

*RMA believes that the revised instructions in combination with the new program structure properly address the concerns underlying this recommendation.*

**OIG Position**

To accept management decision for this recommendation, we need copies of the new nursery policy, the Underwriting Guide, and the Loss Adjustment Manual. We also need specific details regarding how the new policy will clarify responsibility for verifying the reasonableness of inventory values, and the timeframes for implementation of the new policy and instructions.

**Recommendation  
No. 1c**

Review producer D's reinsured company's policies and procedures for inventory verification to ensure that employees

understand and implement SRA and FCIC requirements for inventory verification.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied that "RMA will review the reinsured company's policies and procedures to ensure accuracy and completeness, and will require the company to distribute such policies to all employees involved in the nursery crop insurance program. This action should be completed within 90 days."

**OIG Position**

We accept the management decision for this recommendation.

**Finding No. 2  
Producer Was  
Indemnified for  
Uninsured Inventory**

Producer D's reinsured company also paid indemnities totaling \$286,992 on 1995 crop inventory that was not insured. The producer did not report an increase in inventory to the company, and the company's QC review failed to discover the discrepancy. The added inventory would have required an additional preacceptance inspection and would have resulted in an additional premium of about \$48,850.

Table 2 shows producer D's loss claim experience for 1995.

PLANT TYPE	INSURED INVENTORY		DAMAGED/DESTROYED INVENTORY	
	CONTAINERS <sup>1</sup>	TOTAL VALUE	CONTAINERS	INDEMNITY
Kentia Palm	316,373	\$1,962,466	546,109	\$2,249,458
Areca Palm	120,000	324,000	222,000 <sup>8</sup>	258,362
Other Plant Inventory	232,426	862,262	250,996	437,052
<b>Totals</b>	<b>668,799</b>	<b>\$3,148,728</b>	<b>1,019,105</b>	<b>\$2,944,872</b>

<sup>1</sup> This column contains all container sizes insured for the producer.

**TABLE 2**

As shown in Table 2, the maximum liability for kentia palms was \$1,962,466. However, the producer actually received \$2,249,458, resulting in an overpayment of \$286,992. The excessive indemnity occurred as a result of payments made for uninsured kentia palms. The producer insured 316,373 kentia palms, but

was indemnified for 546,109. These additional 229,736<sup>9</sup> kentia palms (546,109 - 316,373), which were not in the initial insured inventory and were never reported as added inventory, would have required an additional preacceptance inspection and additional premium of about \$48,850.

We noted that the reinsured company's QC review did not identify that the producer's inventory had increased substantially and, therefore, was not reported to the sales agent. Moreover, the loss adjuster, when performing loss claim inspections and determinations, did not note the increased inventory.

**Recommendation  
No. 2a**

Recover from the reinsured company the \$286,992 indemnity that was improperly paid.

**RMA Response**

In its November 12, 1998, response, RMA deferred agreement to recover the funds until such time that the RCFO has completed a review of the workpapers.

**OIG Position**

To accept management decision for this recommendation, we need the details and applicable timeframes for recovery from the reinsured company of the cited questionable indemnity.

**Recommendation  
No. 2b**

Take appropriate actions to ensure that reinsured companies verify inventory values at the time policies are written and that future indemnity payments are based only on a loss of insured inventory.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied that

*Procedures have already been implemented for the 1999 crop year that drastically curtails the Government's vulnerability to fraud based on inflated inventories. Principal changes include a new policy structure that alters the way in which inventory values are used, new inspection and loss adjustment requirements, evaluation of the inventory at loss adjustment rather than application time, and the use of USDA's plant prices instead of the growers'. RMA believes that these changes properly address the concerns underlying this recommendation.*

**OIG Position**

To accept management decision for this recommendation, we need a copy of the new procedures with details regarding (1) how and when inventory will be valued, (2) the new inspection and loss adjustment requirements, (3) the FCIC insured plant values, and (4) specific RMA policy which ensures that future indemnities are only paid on losses of insured inventory.



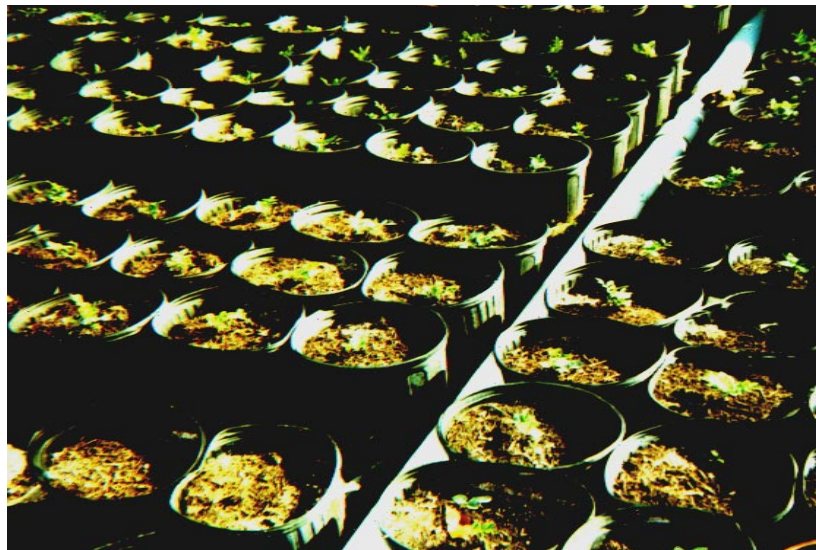
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**Finding No. 3**  
**Reinsured Company**  
**Used Crop Values for**  
**Estimated Growth--**  
**Not Actual**

We identified another reinsured company that, while performing preacceptance inspections, did not ensure that plant values were reasonable. In this case, the producer valued his inventory at the fully mature stage of growth rather than the actual stage the crops were in.

To ensure that loss claims are not inflated because of inaccurate plant values, FCIC instructions require that the producer report the value of his/her expected inventory on a monthly basis. For determining premium rates, the producer must provide a listing showing the plant type, container size, and expected wholesale value for each month of the 12-month insurance period. The producer's premium is based on the highest monthly inventory value.

For the 1998 crop-year, producer F insured approximately 3,000 jasmine and carrissa plants in 3-gallon containers of recently transplanted liner<sup>10</sup> stock. Producer F stated that the value of these plants was actually less than \$1 each, but they were insured at their full-market value of \$3.75 to \$4.50 per container. He stated that it would take at least 4 to 5 months before the plants reached their full-market value. The following photographs show the substantial size difference between a mature, marketable 3-gallon plant with a value of \$3.75 and a recently transplanted liner in a 3-gallon container with a value of less than \$1.



**Transplanted liners insured at the full market 3-gallon value.**



#### **Actual size of mature 3-gallon plants.**

When questioned why he insured the plants at their final market value instead of the current value, the producer stated that he was instructed by his reinsured company sales agent to provide an inventory listing of what he expected his highest monthly inventory value would be for the 1998 crop-year. Therefore, the listing showed an estimated value of his inventory at the mature, marketable stage rather than the value at the time of application.

The loss adjuster used the inventory listing, which was a list of plants by type and container size and included the wholesale price of each plant, to perform a preacceptance inventory inspection. However, he did not note that the inventory included plants which were recently transplanted liners with a current value of less than \$1 each, but were insured at their full-market value ranging from \$3.75 to \$4.50 each. In addition, the loss adjuster did not require the producer to adjust the inventory value to reflect the expected monthly plant values as required by FCIC instructions.

Both the sales agent and the adjuster accepted and used the inventory summary to determine the guarantee. If an insurable disaster were to occur and destroy the plants before they reached their mature marketable stage, the producer would be indemnified based upon the insured value ranging from \$3.75 to \$4.50 per plant, rather than the correct, actual value which could also be as low as \$1 each at the time of the loss.

***Recommendation  
No. 3***

Review producer F's reinsured company's policies and procedures for inventory verification to ensure that employees understand and implement SRA and FCIC requirements for inventory verification.

***RMA Response***

In its November 12, 1998, response, RMA concurred with our recommendation and replied "RMA will review the reinsured company's policies and procedures to ensure accuracy and completeness, and require the company to distribute such policies to all employees involved in the nursery crop insurance program. This action should be completed within 90 days."

***OIG Position***

We accept the management decision for this recommendation.

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**CHAPTER 4  
LOSS ADJUSTMENT ACTIVITIES  
WERE NOT PROPERLY PERFORMED**

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Reinsured companies did not properly perform loss adjustment activities. When conducting loss claim reviews, adjusters did not verify the cause of loss and did not perform all the required tasks necessary to ensure that indemnity amounts were correct and justified.

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***Finding No. 5  
Questionable Loss  
Adjustment  
Activities Continued  
in 1997***

We also accompanied and reviewed loss adjuster activities when performing crop-year 1997 loss determinations. During our review, we noted more adjuster deficiencies in performance of their duties. Examples include: (a) Laboratory samples were not independently selected by the adjuster, (b) adjusters did not count damaged and undamaged inventory and verify that plants with zero value were destroyed and not added back to insured inventory, and (c) plants were not inspected to ensure they were damaged to the extent reported by the producer.

**Laboratory Samples Not Independently Selected**

When conducting loss claim inspections, adjusters relied on laboratory analysis of plant samples selected by producers. This occurred during inspections of disease damaged inventory performed at producers F's and G's nurseries. We found that laboratory results used to substantiate disease were from plants which were not independently selected as required by FCIC instructions. Plants selected for laboratory analysis were selected by a lab employee for producer F, while producer G selected his own plants. Adjusters were not present when the samples were selected and could not ensure that the sampled plants and subsequent laboratory analysis reports were representative of the damaged, indemnified inventory.

**Adjusters Did Not Count Damaged and Undamaged Inventory**

We observed a 1997 loss claim inspection of producer F's nursery and noted that the adjuster did not count the number of damaged plants. The adjuster and the producer negotiated the number of damaged plants to be included when computing the indemnity due. The producer reported that he had 360 damaged plants; however, after discussions with the adjuster, the producer adjusted the number to 250 plants. The adjuster approved the indemnity for the 250 plants, although we were only able to verify about 150 damaged plants.

We also noted that the adjuster did not count the undamaged nursery stock which is required by FCIC instructions and is necessary when computing the indemnity amount. The nursery had about 100 containers of undamaged stock of the same size and variety as the damaged plants in another part of the nursery which were not included on the proof of loss. We visited the nursery the day after the joint visit with the adjuster to count the damaged plants that were to be dumped. The producer informed us that he had already destroyed the damaged plants and had already repotted all the empty containers from which the

damaged plants were taken. However, we examined the dump pile and were only able to locate the remains of about five plants.

The undamaged, uncounted plants observed the day before and not included in the loss calculations had been moved to another location in the nursery, much closer to the location of the damaged plants observed the day before. We noted the number of undamaged plants had increased from about 100 to over 200 plants. It appeared that the producer had not destroyed all the damaged plants but, instead, commingled the supposed damaged plants with the undamaged plants.

### **Extent of Plant Damage Not Verified**

We noted that the adjuster did not inspect the damaged plants to determine the extent of damage for producer F during a loss claim inspection. The producer reported the plants were destroyed by disease and had zero remaining value. The adjuster just visually examined the plants as a group and did not select an individual plant for closer scrutiny. As a result, no plants' root system and/or foliage was closely examined, and the adjuster could not ensure plants were damaged to the extent reported by the producer. We observed only about 5 plants that appeared dead, approximately 10 others had 1 or 2 dying limbs, and the remainder of the plants looked healthy, particularly when compared to other plants of the same size and type that were not being claimed.

Because of loss adjuster deficiencies in producer B's crop-years' 1995 and 1996 indemnities and in crop-year 1997 loss claim determinations for producers F and G, we concluded that the reinsured company's loss adjustment activities were not properly performed. For information concerning other loss adjuster deficiencies, see Chapter 4.

***Recommendation  
No. 5a***

Review the circumstances regarding the loss claims of producer F and recover from the reinsured company any indemnity that was improperly paid.

***RMA Response***

In its November 12, 1998, response, RMA deferred agreement to recover the funds until such time that the RCFO has completed a review of the workpapers.

***OIG Position***

To accept management decision for this recommendation, we need the details and applicable timeframes for recovery from the reinsured company of the cited questionable indemnity.

**Recommendation  
No. 5b**

Provide oversight and monitoring to ensure that in the future, reinsured companies perform all required loss adjustment activities.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied

*The Federal Crop Insurance Corporation's (FCIC) 1998 standard reinsurance agreement (SRA), which is administered through RMA, requires reinsured companies to provide a detailed report of their quality control program results to RMA. RMA's Compliance organization conducts an analysis of the quality control programs, followed by a survey of potential problem areas. If problems are identified during the survey, targeted reviews are performed by Compliance Field Offices (CFO). RMA Compliance is currently conducting a national survey of the nursery program to determine if the problems found in the program in south Florida exist nationwide. The preliminary results show many of the same problems do exist nationwide and at least one CFO anticipate[s] conducting a follow-up audit. The survey is also addressing potential concerns with the newly issued nursery policies, affective for the 1999 crop year.*

*In addition to the above actions, RMA Compliance has several program reviews scheduled for the 1999 crop year in its annual Plan of Review. These program reviews focus on crops with identified problems, including some specialty crop programs.*

**OIG Position**

Based on the above response and other actions being taken as shown in RMA's responses to Recommendations Nos. 7 and 8, we accept the management decision for this recommendation.

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**CHAPTER 5 - FINDING NO. 6**  
**RMA's SYSTEM FOR IDENTIFYING AND**  
**SANCTIONING PRODUCERS WITH**  
**ABNORMAL LOSS HISTORIES**  
**WAS NOT EFFECTIVE**

---

RMA's automated nonstandard classification system (NCS) was not effective in identifying those producers that had excessive crop insurance losses. NCS did not match all available data to identify producers with histories of large indemnities. Consequently, one producer continued to purchase insurance coverage at the same premium levels as producers with little or no loss experience. This producer underpaid his crop insurance premiums by over \$3.1 million for crop-years 1997 and 1998.

Federal regulations require RMA to identify and individually rate high risk policyholders. To address this responsibility, the agency issued regulations<sup>11</sup> to implement the NCS in 1991. The objective of NCS was to identify those insured producers who were collecting a disproportionate percentage of all crop insurance indemnities and individually adjust their coverage and/or rates to offset the higher risk without affecting the majority of insureds.

Raising premiums on high-risk growers allows RMA to recover losses or avoid further indemnity payments by convincing the high-risk growers to seek risk protection elsewhere. We found this to be the case with five nursery producers (three in Florida and two in Texas). These producers were identified by the NCS for crop-year 1997, the first year the NCS was in effect for nurseries. RMA used the producers' insurance experience for crop-year 1995 and prior years to determine if the producers met NCS criteria. The premiums for the three Florida producers would have increased substantially for the 1997 crop-year, in one case by as much as \$437,000 (a 1,383 percent increase over the pre-NCS premium). As a result, none of the three producers purchased crop insurance coverage for 1997.

The two nurseries in Texas selected for the NCS designation also declined to purchase crop insurance for 1997.

NCS procedures apply when a producer has three or more indemnified losses which exceed earned premium during the base period and satisfies other actuarial criteria. We found that because NCS selected producers based on a name match only, producers with name discrepancies who met the loss criteria were not selected. Under these circumstances, a high-risk producer who wished to circumvent NCS detection and avoid higher premiums could do so by changing names.

Producers are selected from the data base based on their loss history and the name of the nursery entity. However, to be selected for the NCS list, producers' names must be exactly the same from year to year, before their loss histories can be matched and identified as possible NCS candidates. For example, if a nursery's proper name was John A. Smith Nursery, Inc., and was entered into the data base by the reinsured company as John Smith, Inc., one year, Smith Nursery, the second year, and John A. Smith Nursery, Inc., the third year, the producer would not have been identified as a possible NCS candidate.

Because exact name matches are required, the NCS did not identify producer E as an NCS candidate even though he had qualifying insurance experience.<sup>12</sup> The producer's insurance data was entered into the system under different names and identification numbers for the 1993 through 1996 period. Moreover, we found that the producer has changed the entity's name for the 1998 crop-year.

For crop-year 1997, the producer's premium rate should have gone up from about 3 percent of his \$3 million liability to 65.9 percent which would have increased his premium from \$82,286 to \$1,986,164. However, the incorrect smaller premium was charged and the producer subsequently was paid a \$950,000 indemnity. Producer E was also not identified for the 1998 crop-year as an NCS candidate. As a result, the producer underpaid his 1998 premium by \$1,245,288. The subsequent premium increases would likely have deterred the producer from purchasing crop insurance coverage and would have saved the Government approximately \$950,000 in indemnities paid the producer for crop-year 1997, plus any other indemnities received in subsequent years.

Table 3 shows that the producer underpaid his premiums for crop-years 1997 and 1998 by a total of \$3,149,166.

	1997	1998	Totals
Liability	\$3,013,906	\$2,551,129	\$5,565,035
Correct Premium Percentage	65.90	52.40	--
Correct Premium	1,986,164	1,336,792	3,322,956
Premium Percentage Used	2.73021	3.58680	--
Premium Paid	82,286	91,504	173,790
Underpaid Premium	\$1,903,878	\$1,245,288	\$3,149,166

**TABLE 3**

If the use of differing names and identification numbers were intentional NCS evasive actions, the producer would not be eligible for the \$3.7 million of indemnities received for the 5-year period 1993 through 1997. RMA regulations state that if a producer acted with the purpose of evading the assignment of the nonstandard classification, the producer will be ineligible to receive any and all benefits applicable to any crop-year for which his evasive actions were used.<sup>13</sup> Table 4 shows the insurance experience of producer E.

CROP-YEAR	PRODUCER PREMIUM	TOTAL PREMIUM	LIABILITY	LOSS RATIO	INDEMNITY
1993	\$ 18,412	\$ 26,299	\$ 690,299	8.27	\$ 217,540
1994	31,047	39,308	952,339	11.56	454,239
1995	55,099	82,239	1,525,399	17.80	1,463,483
1996	61,340	87,627	1,995,130	8.03	703,220
1997	82,286	132,372	3,013,906	7.17	949,310
TOTALS	\$248,184	\$367,845	\$8,177,073	-	\$3,787,792

**TABLE 4**



***RMA Identified NCS  
Deficiencies***

In May 1997, RMA's Claims Services Division (CSD) reported that improvements were needed within the NCS. The RMA solicited industry and governmental agency officials for suggestions on how to reduce RMA and taxpayer vulnerability by improving the NCS. The CSD identified problems similar to those found during our audit. Comments made in a June 1997 CSD position paper regarding NCS problems included the following.

- The reliability of data in the experience data base is often suspect.
- The selection process is inconsistent--persons with no recent insurance experience have been selected while producers with excessive losses have not.

RMA is currently reviewing options and has recommended replacing NCS beginning in 1999 with a system that will incorporate rate changes as a means to charge appropriate premium rates which recognize the additional risk of producers with lower than average yields. During the exit conference, RMA officials explained that the new system would be based on a producer's actual production history (APH). Those producers with a low APH would be rated higher, thereby requiring their premium rates to be higher. We asked how rates would be determined for crop insurance policies for nurseries and other specialty crops which do not require APH's. RMA officials stated that the proposed NCS replacement system would not adjust rates for any crops where APH's are not required. As a result of this discussion, RMA officials stated that they will revisit the proposed replacement system for NCS to make changes which would include non-APH crops.

Once the details of the new system are available, OIG will review it to ensure that the system identifies and individually rates those producers with abnormal loss experience without affecting premium rates of the rest of the policyholder population.

Details concerning payments made to producer E were provided to OIG-Investigations for further review regarding possible criminal violations.

***Recommendation  
No. 6a***

After consulting with OIG-Investigations, determine if producer E and/or the reinsured company acted with the purpose of evading the assignment of the NCS designation. If appropriate, implement sanctions against the reinsured company and require reimbursement of all ineligible indemnity payments from the appropriate party.

**RMA Response**

In its November 12, 1998, response, RMA advised that a determination regarding actions to be taken could not be made until final disposition of the investigation.

**OIG Position**

OIG-Investigations has accepted the cited case for investigation. However, this does not necessarily mean that administrative actions cannot be initiated to recover the questionable indemnities. Therefore, RMA should coordinate with OIG-Investigations for direction regarding what actions may be taken. To accept management decision, RMA should provide us with the details and timeframes regarding actions to be taken against the cited producer and reinsured company.

**Recommendation  
No. 6b**

Determine if producer E is NCS qualified for the 1999 crop-year. If so, ensure his premium rates are adjusted as required by NCS instructions.

**RMA Response**

In its November 12, 1998, response, RMA did not agree with the recommendation and replied

*RMA published a proposed rule (General Administrative Regulations; Nonstandard Underwriting Classification System) on September 2, 1998, to remove and reserve Subpart O of the General Administrative Regulations, effective for the 2000 and succeeding crop years. When the existing Non-standard Classification System (NCS) regulation is removed, RMA will replace NCS with an alternative rating system that increases the rate for insureds with lower than average yields. By using an alternative that simply requires adjustment to the current rating methodology as a replacement for NCS, the proposed removal of the NCS regulation can be implemented beginning with the crops planted in the fall of 1998. For this reason the NCS program has been suspended for the 1999 crop year.*

**OIG Position**

As stated above and as further described in RMA's response to Recommendation No. 6c, RMA has eliminated NCS for all crops for the 1999 crop-year. The replacement system is not available for certain crops, such as nurseries, that do not have an APH. We believe that to comply with the Federal regulations that resulted in RMA's implementation of NCS in 1991, RMA must have a system in place to identify and individually rate high risk policyholders for all crops, including those crops without an APH. Therefore, to accept management decision for this recommendation, RMA should provide details of its determination regarding whether the cited producer meets the (former) NCS requirements for the 1999 crop-year, and if so, the actions to be taken, with timeframes, for adjusting the producer's premium rates.

**Recommendation  
No. 6c**

Provide OIG with the details of the system being proposed which will replace NCS, specifically as it pertains to nurseries.

**RMA Response**

In its November 12, 1998, response, RMA replied

*The NCS, a method for adjusting either or both the premium rate or guarantee amount for insureds with unusually large or frequent claims, has been eliminated for all crops for the 1999 crop year. For most crops, NCS was redundant with the Actual Production History (APH) and rate-span mechanisms imbedded in FCIC's underwriting procedures. Nursery, however, does not use the APH and rate-span mechanisms and thus is unable to fall back on them. This does not create a significant program vulnerability for FCIC, however, because very few nursery insureds (4) were on NCS for 1998 and because the general restructuring of the nursery program for 1999 eliminates many of the opportunities that may have led to past abuses. RMA will analyze whether a new system to individually underwrite carryover nursery insureds is necessary and, if so, what would be the most feasible and effective system.*

**OIG Position**

Federal regulations require RMA to identify and individually rate high risk policyholders. This requirement is applicable to all crops, including those without an APH, such as nurseries. Even though there may have been only four producers on NCS for 1998, our audit disclosed that NCS had not been effective in identifying all producers that had excessive crop insurance losses. In addition, as shown by the details cited above for producer E, the cost to RMA for not properly adjusting the premium rates for any one producer who is NCS qualified can be very expensive. Therefore, RMA should establish a system to replace NCS which is applicable to crops without an APH. To accept management decision, RMA should provide us the details of the new system with the timeframes for implementation.

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## CHAPTER 6

### MANAGEMENT OF THE NURSERY CROP INSURANCE PROGRAM BY RMA AND THE REINSURED COMPANIES WAS INADEQUATE

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RMA and the reinsured companies have not adequately managed the Nursery Crop Insurance Program. RMA did not provide sufficient oversight of the program, but relied instead on the reinsured companies' QC reviews to ensure program compliance. We found that these QC reviews were inadequate. When RMA did identify a problem, no corrective action was taken.

We also determined that RMA has proposed changes to its regulations that would further weaken enforcement of program requirements. These changes would allow growers to gain coverage after setting their own values on the plants, and they would indemnify growers against circumstances that are considered normal.

Some of the deficiencies noted in program management had been reported in prior OIG audit reports.

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***Finding No. 7  
RMA Did Not Take  
Corrective Action to  
Address Identified  
Problems***

Although RMA does not routinely perform reviews of indemnities paid to nurseries, the agency's compliance division did conduct a review of the Nursery Crop Insurance Program for crop-year 1995. The review was conducted at the request of senior RMA management because of reports received of exorbitant and exaggerated claims and coverages.

RMA's compliance division concluded in its February 1996 summary report of nursery operations that (a) complaints of overstated indemnities had merit and that actions taken by producers and the reinsured companies contributed to the overpayments and (b) reinsured companies' QC programs were deficient.<sup>14</sup> RMA further concluded the following.

- Policy provisions allowed indemnities to be paid for perils (market risks) that were outside FCIC authority under the Crop Insurance Reform Act of 1994.<sup>15</sup>
- Loss adjuster errors created indemnity overpayments.

- Policy and procedural deficiencies established an environment where producers can create or exaggerate the severity of plant losses.
- The nursery handbook was inadequate and had a negative effect on FCIC's goal of uniform loss adjustment.
- Insurers do not have a sufficiently trained loss adjustment force in place to timely administer nursery losses in the event that a major catastrophe were to occur.
- A continued compliance presence was needed in south Florida to address problems with the Nursery Crop Insurance Program.

Although the compliance division reported a number of major concerns in its summary report, no specific corrective actions were recommended. Senior compliance officials stated that the report was issued to key RMA management officials, but no policy or procedural changes resulted from the report.

**Recommendation  
No. 7**

Require that compliance division reports include recommendations for corrective actions and a response from the accountable RMA division.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied

*Risk Compliance will develop and implement a formalized reporting process for addressing program findings, disclosed during policy or company reviews, directly to the responsible RMA office. The report will be referenced to the review that generated the finding so that results can be tracked. The report will include findings and recommendations for corrective actions and will specifically address the accountable manager(s) to whom the findings and recommendations are directed. The new reporting process is expected to be operational by July 1999.*

*The recommendation is identical to recommendation number 3 in the discussion draft report for audit number 05005-1-Ch, "Risk Management Agency Controls over Monitoring of Private Insurance Companies." RMA requests this recommendation to be addressed in the 05005-1-Ch audit and thus removed from this audit.*

**OIG Position**

We accept the management decision for this recommendation.

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**Finding No. 8  
Reinsured Company  
QC Reviews Were  
Deficient**

Our review showed that insurance company QC reviews of indemnity payments were systemically deficient and that they failed to identify any of the program deficiencies cited in this report.

Current RMA policy provides that reinsured companies are required to provide a QC review plan of their activities to the FCIC. The plan must include procedures necessary to monitor producer certification, determination, and verification of yield data and other information necessary to establish insurance guarantees and indemnities. FCIC instructions provide that the insurance company shall conduct special loss audits when loss claims exceed \$100,000 and that these audits shall be performed by experienced, qualified, competent company QC personnel.<sup>16</sup>

None of the reinsured company QC reviews performed on the loss claims of the five producers identified the problems OIG found during this audit. [

]. We found that the QC reviews were superficial and that they only consisted of a series of questions requiring "yes" or "no" responses, with no actual indepth review of the loss claim. The cited improper payments could have been avoided had the reinsured companies conducted more detailed reviews of the losses.

**Recommendation  
No. 8**

Develop a plan of action to ensure reinsured companies comply with program regulations in their management of the Nursery Crop Insurance Program. The plan of action should include specific steps to be taken to correct the deficiencies identified in reinsured companies' activities regarding sales and servicing, loss adjustment, and QC reviews.

**RMA Response**

In its November 12, 1998, response, RMA concurred with our recommendation and replied

*The RCFO will conduct a follow-up review of findings determined by OIG to ensure compliance with program regulations. RCFO will request the OIG to forward its work papers to the Reinsurance Service Division (RSD). Upon receipt of the OIG work papers, RSD will contact each company involved to require that the company develop an action plan to address the identified vulnerabilities. RSD will conduct an on-site visit to ensure the company's action plan has been implemented. This action is expected to be completed within 6 months.*

***Finding No. 9  
Proposed Changes  
Further Weaken the  
Nursery Crop  
Insurance Program***

As a result of complaints expressed by growers, agents, and company representatives regarding the complexity of the program, RMA's Research and Evaluation Division drafted proposed changes to the nursery crop provisions for crop-year 1999. In a September 19, 1997, memorandum to the RMA Administrator, OIG questioned two of the proposed changes applying to inventory reporting and the insurable perils of disease and insect infestation.

**RMA Eases Inventory Reporting Requirements**

Under the proposed changes, nurseries will no longer be required to provide a detailed inventory listing of plants by type, container size, and by value when purchasing coverage. Nurseries will only be required to report the aggregate value of the inventory to be insured.

RMA proposed the changes because it recognized that the current method of allowing producers to set inventory values was flawed. Current provisions require nurseries to provide a detailed listing of the inventory onhand and projected inventory for the 12-month insurance period. The listing must contain the following information for each plant insured: Container size, number of containers, and wholesale price per container for each month of the 12-month insurance period.

The proposed changes (designed to simplify the process and promote marketability) discontinue the requirement for a detailed inventory listing to purchase coverage. The new policy requires the growers to report the aggregate value of their inventory and to identify their growing practice (whether the crop is grown in a container or a field). The grower will no longer be required to report the plant type or the projected plant values. Inventory verification will not be required during the preacceptance inspection.

We concluded that under these conditions, insurance coverage may be purchased on uninsurable plants and inventory values may be incorrect (see Chapter 1). Inventory verification will only be required if the grower files a loss claim as a result of an insurable cause. However, verification may not be feasible at that time, and an accurate assessment of losses may not be possible.

To address program procedures which allow nurseries to set their own plant values when purchasing coverage, RMA is developing a plant listing which will indicate the maximum amount the agency will pay for insurable plants. However, the draft provisions do not require the plant listing to contain plant values by container size.

### **RMA Changes Rules on Disease and Insect Infestation Perils**

RMA also proposed to discontinue allowing disease and insect infestation to be insurable perils except when certain conditions occur as a result of adverse weather.

Adverse weather, such as heavy, continuous rain, is a normal and common occurrence in Florida. These adverse, yet normal, weather conditions readily promote disease in some plants and may prevent application of control measures. Producers advised us that these conditions are expected in the Florida nursery industry. Therefore, they plan for diseases and insect infestation and can minimize the detrimental economic impact caused by adverse weather conditions.

For example, professional nurserymen told us that bougainvillea, which is a common Florida nursery plant, experiences symptoms of disease nearly every spring and summer caused by heavy, frequent rainfall. The excess precipitation causes the plant to lose foliage and appear dead. However, nursery producers expect and plan for the plant damage caused by the adverse weather conditions. Once the symptoms occur, they treat the plant with chemicals and are able to rehabilitate and quickly market the plant.

We recommended in our September 19, 1997, memorandum that RMA not implement its proposed changes concerning plant inventory and coverage conditions. We believed that if the proposed changes were implemented, the risk of improper indemnities would increase, program accountability would be reduced, and the opportunity to verify nursery inventory through onsite review would no longer be available.

During the exit conference, RMA officials provided additional information regarding proposed changes for inventory reporting requirements. RMA officials stated that the new provisions would require producers to sign the policy acknowledging that indemnities will only be paid for actual damaged crops and not the guarantee amount. In addition, the producer will be required to provide, at the reinsured company's request, all documentation supporting the existence of the damaged/destroyed crops. As applicable, this would include



inventory records of damaged plants. RMA officials believed that the new system would actually decrease the opportunity for improper claims by producers.

**Recommendation  
No. 9**

Provide specific details and timeframes of the proposed changes regarding disease and insect infestation perils and inventory reporting requirements for nurseries to us for review and comment.

**RMA Response**

In its November 12, 1998, response, RMA did not agree that producers should be required to provide a detailed listing of plants, their container size, and the projected inventory for each month of the insurance period. RMA argued that this system "appears to be illegal, unwise, and excessive. In addition, RMA believes that it may have created vulnerabilities for FCIC. This is because there was a tendency for judges to hold that because FCIC and the companies insisted on the report at application time, inspected the nursery, and accepted the values in the report and issued the policy, that they must pay on that report and could not reject it or challenge its veracity."

RMA further advised that "the new nursery policy asks for no such report, but puts the grower on notice that losses will be adjusted on FCIC 's published prices and the actual plants and sizes that exist at the time of the loss."

RMA agreed with our position that coverage for damage caused by disease and insect infestation should only be provided when no approved, effective control measure exists. Such requirements have been incorporated into the new nursery regulations which have already been published.

**OIG Position**

Based on RMA's position that the new nursery policy will provide necessary safeguards to ensure that producers will only be indemnified for actual inventory on hand at the time of loss, we accept the management decision for this recommendation.

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**Finding No. 10  
RMA Oversight of  
Large Loss Claims  
Needs Improvement**

Current RMA regulations do not require the agency to perform pre-verification or final reviews of producers' activities when the producers have filed claims which result in large indemnity payments. Instead, RMA relies on the reinsured companies' QC reviews to ensure program compliance. However, as previously stated, the insurance companies' QC reviews did not identify deficiencies in the cases we reviewed. In our opinion, RMA should require pre-verification reviews.

RMA's system for identifying and sanctioning producers with abnormal loss histories also was not effective (see Finding No. 6). RMA allowed producer E, with a history of losses, to continue purchasing crop insurance but did not adjust his premium rates to recover substantial past losses. Had RMA maintained effective oversight, the agency would have discovered that the producer's coverage and premium rates should have been adjusted. As a result, producer E was undercharged premiums by approximately \$3.1 million for crop-years 1997 and 1998.

Prior OIG audits have also noted deficiencies in RMA's oversight of indemnity payments. Those audits recommended that RMA perform a detailed review of indemnities above a prescribed dollar threshold. Because these recommendations remain unresolved, we will not reiterate them in this report.

1. Standard Reinsurance Agreement between the FCIC and Reinsurance Company, § V, paragraph F.5., effective July 1, 1994.
2. 7 CFR, paragraph 406.7(d) 3.a., effective January 1, 1995.
3. FCIC Nursery Crop Provisions, paragraph 3(d), effective crop-year 1995.
4. The word "company" is used to indicate the reinsured company FCIC contracted with to provide crop insurance coverage for nurseries.
5. Container size is determined by the inside top diameter of the container. A 6-inch container is equivalent to a 1-gallon container, and an 8-inch container is equivalent to a 2-gallon container.
6. FCIC 30280, paragraph 2B, effective December 2, 1994.
7. FCIC Nursery Crop Provisions, paragraph 6(e), effective 1989.
8. This amount includes plants that suffered damage from more than one insurable peril. As a result, the damaged/destroyed inventory count will be greater than the original insured inventory total. For example, one plant may have suffered 20 percent damage from the first insurable peril and later suffered additional damage as a result of another peril. This would cause this plant to be counted twice for damaged/destroyed inventory purposes.
9. Indemnified kentia palms minus insured kentia palms (546,109 - 316,373); difference in insured and indemnified containers for areca palms and other plant inventory was caused by plants only partially destroyed.
10. "Liners" are plants produced from seeds or cuttings in a controlled environment by greenhouse operators and normally sold to other growers.
11. 7 CFR, paragraph 400.301, effective January 1, 1991.
12. "Insurance experience" means premium earned, indemnities paid, and other data resulting from a crop insurance policy insured or reinsured by FCIC.
13. 7 CFR, paragraph 400.458, effective January 1, 1996.
14. RMA Raleigh Compliance Office - 1995 South Florida Nursery Monitoring Report, dated February 1, 1996.
15. Public Law 103-354, 108 Stat. 3186 (1994).
16. FCIC Directive 14010, paragraph 8a, effective July 22, 1994.

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**CHAPTER 7 - EXHIBIT A  
SUMMARY OF MONETARY RESULTS**

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FINDING NUMBER	DESCRIPTION	AMOUNT	CATEGORY
2	Producer Was Indemnified for Uninsured Inventory	\$ 286,992	Questioned Costs- Recovery Recommended
[			]
6	Premiums Not Collected	3,149,166	Questioned Costs - No Recovery
<b>TOTAL MONETARY RESULTS</b>		<b>\$3,963,468</b>	

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**EXHIBIT B  
LOCATIONS VISITED**

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ORGANIZATION/ENTITY	LOCATION
<b><u>U.S. Department of Agriculture</u></b>	
Risk Management Agency National Office Regional Service Office Regional Compliance Office	Washington, D.C. Valdosta, Georgia Raleigh, North Carolina
Farm Service Agency State Office Dade County Office	Gainesville, Florida Homestead, Florida
Natural Resources and Conservation Service Dade County Office	Homestead, Florida
<b><u>U.S. Department of Commerce</u></b>	
National Weather Service National Oceanic and Atmospheric Administration	Miami, Florida
<b><u>Florida Department of Agriculture</u></b>	
Division of Plant Industry	Miami, Florida; and Homestead, Florida
<b><u>University of Florida</u></b>	
Cooperative Extension Service	Homestead, Florida

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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT


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United States Department of Agriculture

Farm and Foreign Agricultural Services  
Risk Management Agency

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

FROM: Kenneth D. Ackerman  NOV 12 1998  
Administrator

SUBJECT: Office of Inspector General's (OIG) Audit Report 05099-2-At - Crop  
Insurance for Nurseries, Crop Years 1995 Through 1996

Outlined below is our response to the recommendations in the subject audit.

#### RECOMMENDATION NO. 1a

*Recover from the reinsured company that portion of the \$2,944,872 paid to producer D that was improper because of inflated inventory values.*

#### Risk Management Agency (RMA) Response:

RMA does not concur. We cannot determine the appropriate action to be taken until the RMA Raleigh Compliance Field Office (RCFO) has completed a review of the work papers.

#### RECOMMENDATION NO. 1b

*Revise instructions to clarify responsibility for verifying the reasonableness of inventory values for sales and loss adjustment purposes.*

#### RMA Response:

RMA concurs. The Federal Crop Insurance Corporation (FCIC) introduced an entirely new nursery policy for the 1999 crop year, which began on October 1, 1998. As part of this new program, it will issue an Underwriting Guide and a Loss Adjustment Manual, as well as various forms, including new inspection forms. The Underwriting Guide provides specific instructions for such inspections.



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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

2

In addition, the structure of the new policy reduces the vulnerability of the program to losses based on the reported values. Growers' prices are no longer used. Rather, FCIC has published a list of prices to be used when working losses.

RMA believes that the revised instructions in combination with the new program structure properly address the concerns underlying this recommendation.

*RMA requests management decision be reached on recommendation 1b.*

#### **RECOMMENDATION NO. 1c**

*Review producer D's reinsured company's policies and procedures for inventory verification to ensure that employees understand and implement SRA and FCIC requirements for inventory verification.*

#### **RMA Response:**

RMA concurs. RMA will review the reinsured company's policies and procedures to ensure accuracy and completeness, and require the company to distribute such policies to all employees involved in the nursery crop insurance program. This action should be completed within 90 days.

*RMA requests management decision be reached on recommendation 1c.*

#### **RECOMMENDATION NO. 2a**

*Recover from the reinsured company the \$286,992 indemnity that was improperly paid.*

#### **RMA Response:**

RMA does not concur. We cannot determine the appropriate action to be taken until the RCFO has completed a review of the work papers.

#### **RECOMMENDATION NO. 2b**

*Take appropriate actions to ensure that reinsured companies verify inventory values at the time policies are written and that future indemnity payments are based only on a loss of insured inventory.*

#### **RMA Response:**

RMA concurs. Procedures have already been implemented for the 1999 crop year that drastically curtails the Government's vulnerability to fraud based on inflated inventories. Principal changes include a new policy structure that alters the way in which inventory values are used, new

# EXHIBIT C

## RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

3

inspection and loss adjustment requirements, evaluation of the inventory at loss adjustment rather than application time, and the use of USDA's plant prices instead of the growers'. RMA believes that these changes properly address the concerns underlying this recommendation.

*RMA requests management decision be reached on recommendation 2b.*

### RECOMMENDATION NO. 3

*Review producer F's reinsured company's policies and procedures for inventory verification to ensure that employees understand and implement SRA and FCIC requirements for inventory verification.*

#### **RMA Response:**

RMA concurs. RMA will review the reinsured company's policies and procedures to ensure accuracy and completeness, and require the company to distribute such policies to all employees involved in the nursery crop insurance program. This action should be completed within 90 days.

*RMA requests management decision be reached on recommendation 3.*





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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

4

#### RECOMMENDATION NO. 5a

*Review the circumstances regarding the loss claims of producer F and recover from the reinsured company any indemnity that was improperly paid.*

#### RMA Response:

RMA does not concur. We cannot determine the appropriate action to be taken until the RCFO has completed a review of the work papers.

#### RECOMMENDATION NO. 5b

*Provide oversight and monitoring to ensure that in the future, reinsured companies perform all required loss adjustment activities.*

#### RMA Response:

RMA concurs. The Federal Crop Insurance Corporation's (FCIC) 1998 standard reinsurance agreement (SRA), which is administered through RMA, requires reinsured companies to provide a detailed report of their quality control program results to RMA. RMA's Compliance organization conducts an analysis of the quality control programs, followed by a survey of potential problem areas. If problems are identified during the survey, targeted reviews are performed by Compliance Field Offices (CFO). RMA Compliance is currently conducting a national survey of the nursery program to determine if the problems found in the program in south Florida exist nationwide. The preliminary results show many of the same problems do exist nationwide and at least one CFO anticipate conducting a follow-up audit. The survey is also addressing potential concerns with the newly issued nursery policies, effective for the 1999 crop year.

In addition to the above actions, RMA Compliance has several program reviews scheduled for the 1999 crop year in its annual Plan of Review. These program reviews focus on crops with identified problems, including some specialty crop programs.

*RMA requests management decision be reached on recommendation 5b*

#### RECOMMENDATION NO. 6a

*After consulting with OIG-Investigations, determine if producer E and/or the reinsured company acted with the purpose of evading the assignment of the NCS designation. If appropriate, implement sanctions against the reinsured company and require reimbursement of all ineligible indemnity payments from the appropriate party.*

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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

5

**RMA Response:**

RMA does not concur. We cannot determine the appropriate action to be taken until final disposition of this investigation.

**RECOMMENDATION NO. 6b**

*Determine if producer E is NCS qualified for the 1999 crop-year. If so, ensure his premium rates are adjusted as required by NCS instructions.*

**RMA Response:**

RMA does not concur. RMA published a proposed rule (General Administrative Regulations; Nonstandard Underwriting Classification System) on September 2, 1998, to remove and reserve Subpart O of the General Administrative Regulations, effective for the 2000 and succeeding crop years. When the existing Non-standard Classification System (NCS) regulation is removed, RMA will replace NCS with an alternative rating system that increases the rate for insureds with lower than average yields. By using an alternative that simply requires adjustment to the current rating methodology as a replacement for NCS, the proposed removal of the NCS regulation can be implemented beginning with crops planted in the fall of 1998. For this reason the NCS program has been suspended for the 1999 crop year.

*RMA requests management decision be reached on recommendation 6b.*

**RECOMMENDATION NO. 6c**

*Provide OIG with the details of the system being proposed which will replace NCS, specifically as it pertains to nurseries.*

**RMA Response:**

The NCS, a method for adjusting either or both the premium rate or guarantee amount for insureds with unusually large or frequent claims, has been eliminated for all crops for the 1999 crop year. For most crops, NCS was redundant with the Actual Production History (APH) and rate-span mechanisms imbedded in FCIC's underwriting procedures. Nursery, however, does not use the APH and rate-span mechanisms and thus is unable to fall back on them. This does not create a significant program vulnerability for FCIC, however, because very few nursery insureds (4) were on NCS for 1998 and because the general restructuring of the nursery program for 1999 eliminates many of the opportunities that may have led to past abuses. RMA will analyze whether a new system to individually underwrite carryover nursery insureds is necessary and, if so, what would be the most feasible and effective system.

*RMA requests management decision be reached on recommendation 6c.*

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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

6

#### RECOMMENDATION NO. 7

*Require that compliance division reports include recommendations for corrective actions and a response from the accountable RMA division.*

#### RMA Response:

RMA Concurs. Risk Compliance will develop and implement a formalized reporting process for addressing program findings, disclosed during policy or company reviews, directly to the responsible RMA office. The report will be referenced to the review that generated the finding so that results can be tracked. The report will include findings and recommendations for corrective actions and will specifically address the accountable manager(s) to whom the findings and recommendations are directed. The new reporting process is expected to be operational by July 1999.

This recommendation is identical to recommendation number 3 in the discussion draft report for audit number 05005-1-Ch, "Risk Management Agency Controls over Monitoring of Private Insurance Companies." RMA requests this recommendation to be addressed in the 05005-1-Ch audit and thus removed from this audit.

#### RECOMMENDATION NO. 8

*Develop a plan of action to ensure reinsured companies comply with program regulations in their management of the Nursery Crop Insurance Program. The plan of action should include specific steps to be taken to correct the deficiencies identified in reinsured companies' activities regarding sales and servicing, loss adjustment, and QC reviews.*

#### RMA Response:

RMA Concurs. The RCFO will conduct a follow-up review of findings determined by OIG to ensure compliance with program regulations. RCFO will request the OIG to forward its work papers to the Reinsurance Services Division (RSD). Upon receipt of the OIG work papers, RSD will contact each company involved to require that the company develop an action plan to address the identified vulnerabilities. RSD will conduct an on-site visit to ensure the company's action plan has been implemented. This action is expected to be completed within 6 months.

*RMA requests management decision be reached on recommendation 8.*

#### RECOMMENDATION NO. 9

*Provide specific details and time frames of the proposed changes regarding disease and insect infestation perils and inventory reporting requirements for nurseries to us for review and comment.*

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## EXHIBIT C

### RMA's RESPONSE TO THE DRAFT REPORT

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James R. Ebbitt

7

**RMA Response:**

- 1a. RMA does not concur that the insured be required to provide a detailed listing of plants, their container size, and the projected inventory for each month of the insurance period.

Section 508(b)(10) of the FCIC Act, directs that FCIC, "shall, to the maximum extent practicable, minimize the paperwork required and the complexity and cost of procedures governing applications for, processing, and servicing of the plan for all parties involved." The inventory reports under the old nursery program imposed an excessive, even impossible, burden on growers, agents, and companies. Growers were required to report each plant currently and prospectively in their inventories for each of 12 months. They had to report plant sizes and prices. They had to be accurate, even though the normal nature of their business involves changing plans to take advantage of market conditions. The Director of a Farm Service Agency county office in North Carolina reported that he helped one grower fill in a 254 page inventory report for a CAT policy! For a \$50 fee!

The old system, which OIG's recommendation supports, appears to be illegal, unwise, and excessive. In addition, RMA believes that it may have created greater vulnerabilities for FCIC. This is because there was a tendency for judges to hold that because FCIC and the companies insisted on the report at application time, inspected the nursery, and accepted the values in the report and issued the policy, that they must pay on that report and could not later reject it or challenge its veracity.

The new nursery policy asks for no such report, but puts the grower on notice that losses will be adjusted based on FCIC's published prices and the actual plants and sizes that exist at the time of the loss. This is actually safer for FCIC as it avoids the legal trap described above. The new policy avoids a logical trap, as it does not require growers to do something that they cannot do—accurately predict what plants and values they will have each month for the next twelve months. Finally, it is legal in a way the old policy was not because it complies with the simplification requirements of the FCIC Act.

- 1b. RMA concurs that coverage for damage caused by disease and insect infestation will only be provided when no approved, effective control measure exits.

The new nursery regulations address this situation. They are already published and state as follows with respect to insured perils:

"In addition to the causes of loss excluded in section 12 of the Basic Provisions, we do not insure against any loss caused by:

"(1) Disease or insect infestation, unless:

"(i) A disease or insect infestation occurs for which no effective control measure exits."

*RMA requests management decision be reached on recommendation 9.*

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**EXHIBIT C**  
**RMA's RESPONSE TO THE DRAFT REPORT**

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James R. Ebbitt

8

If there are any questions, please contact Alan Sneeringer on (202) 720-8813 or Tracey Mock on (202) 690-6020.

Risk Management Agency

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## CHAPTER 8 - ABBREVIATIONS

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CAT	Catastrophic Risk Protection
CFR	<u>Code of Federal Regulations</u>
CSD	Claims Services Division
FAIR Act	Federal Agriculture Improvement and Reform Act
FCIC	Federal Crop Insurance Corporation
FSA	Farm Service Agency
MPCI	Multiple Peril Crop Insurance
NCS	Nonstandard Classification System
OGC	Office of the General Counsel
OIG	Office of Inspector General
QC	Quality Control
RMA	Risk Management Agency
SRA	Standard Reinsurance Agreement
USDA	U.S. Department of Agriculture