

**RISK MANAGEMENT AGENCY  
QUALITY CONTROL FOR CROP  
INSURANCE DETERMINATIONS  
WASHINGTON D.C.  
AUDIT REPORT NO. 05099-2-KC**

**JULY 1998**

**UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL - AUDIT  
GREAT PLAINS REGION  
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KANSAS CITY, MISSOURI 64141**



UNITED STATES DEPARTMENT OF AGRICULTURE  
OFFICE OF INSPECTOR GENERAL  
Washington D.C. 20250



DATE: July 14, 1998

REPLY TO

ATTN OF: 05099-2-KC

SUBJECT: Quality Control for Crop Insurance Determinations

TO: Kenneth D. Ackerman  
Administrator  
Risk Management Agency

ATTN: Garland D. Westmoreland  
Deputy Administrator  
for Compliance

This report presents the results of our audit of the Risk Management Agency's (RMA) quality control process for multiple peril crop insurance programs. Your July 1, 1998, written comments on the draft report are included as exhibit A with excerpts and the Office of Inspector General's position incorporated into relevant sections of the report. Your response provided sufficient information to reach management decision for Recommendation Nos. 1a, 1b, 2a, 2b and 2c. We need additional information for management decision on Recommendation Nos. 3, 4, 5a and 5b. Information needed to reach management decision is presented 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 actions taken or planned, plus the timeframes, with respect to Recommendation Nos 2a, 2c, 3, 4, 5a and 5b. Please note that the regulation requires a management decision on all finding and recommendations within a maximum of 6 months from report issuance.

We appreciate the courtesies and cooperation extended to us by members of your staff.

JAMES R. EBBITT  
Assistant Inspector General  
for Audit

# EXECUTIVE SUMMARY

## QUALITY CONTROL FOR CROP INSURANCE DETERMINATIONS AUDIT NO. 05099-2-KC

### PURPOSE

We performed an audit of the Risk Management Agency's quality control (QC) processes for multiple peril crop insurance (MPCI) programs. The audit was included in the Office of Inspector General's 1997 Annual Audit Plan as the result of prior reviews. The purpose of the audit was to determine the adequacy of Risk Management Agency (RMA) policy, procedures, and oversight of the QC systems implemented by the reinsured companies operating under standard reinsurance agreements with the Federal Crop Insurance Corporation (FCIC).

### RESULTS IN BRIEF

The QC systems at 2 of the 19 reinsured companies operating in partnership with the RMA to deliver MPCI programs, did not produce meaningful results for improving program delivery and maintaining program integrity. Although the systems generally complied with FCIC requirements, we found little evidence the reinsured companies' QC results were used to improve overall program performance or to ensure the integrity of the programs. As a result, RMA program officials cannot rely on reinsured companies' QC review systems to assure effective implementation and administration of FCIC reinsurance programs. This weakness in the internal control structure was not reported in the agency's latest (1996) Federal Managers' Financial Integrity Act statements.

The Standard Reinsurance Agreement (SRA) did not include adequate requirements for RMA to ensure the reinsured companies' QC processes were properly established and effectively applied. RMA also did not effectively monitor the progress of QC activities and results to ensure the companies' QC systems produced meaningful results. Although the QC systems of the two companies visited generally complied with the SRA, our audit disclosed three overall weaknesses in the QC processes for MPCI programs.

First, RMA's requirements were not sufficient to ensure reinsured companies collected, maintained, and reported adequate data on MPCI program delivery and related information. One company, while generally complying with requirements, did not maintain sufficient information to operate an effective QC system. A second company implemented internal procedures that were approved by RMA as a part of their plan of operations, but did not meet RMA's procedural requirements.

Second, RMA did not provide effective oversight of reinsured companies' QC operations to ensure that QC processes achieved their intended results. The agency did not require periodic QC progress reports from the reinsured companies or require the companies to establish uniform error rates to measure operational performance and QC effectiveness.

And last, RMA did not implement effective controls to ensure reinsured companies prevented and detected potential conflict of interest situations. We identified several real and potential conflicts of interest which were not detected or prevented. Neither RMA nor the reinsured companies established effective controls for this purpose. One potential control, agent and loss adjuster identification (ID) numbers, was not fully or effectively applied.

## KEY RECOMMENDATIONS

We recommended RMA consult with insurance-related professional organizations, crop insurance experts, and private and Government experts on professional and ethical standards, and develop a strategy for periodically evaluating the effectiveness of QC processes and related reporting functions. RMA and the reinsured companies should agree on organizational and management controls to protect the integrity of QC processes and provide reasonable assurance that potential conflicts of interest are properly controlled.

We also recommended RMA require reinsured companies to (1) calculate annual QC error rates, (2) retain records necessary to evaluate QC processes, (3) adopt RMA procedural requirements without modification, (4) establish controls to prevent company personnel from inappropriately influencing MPCCI program determinations, and (5) separate supervisory responsibilities for claims adjustments from the personnel who supervise sales activities.

## AGENCY POSITION

Agency officials provided a written response to our draft report on July 1, 1998. The response is included as Exhibit A of this report. Excerpts from the Agency's comments are also included in our Findings and Recommendations section. The response showed that agency officials generally concurred with our findings and recommendations regarding the improvements needed to enhance the QC process. The agency has recently applied corrective action to correct noted weaknesses. However, RMA officials did not agree with our findings and recommendations pertaining to the adequacy of RMA's controls to prevent and detect potential conflicts of interest. We believe that our findings on this issue disclose a material internal control weakness which has a significant and negative impact on the integrity of MPCCI programs. We urge agency managers to reconsider their position.

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# INTRODUCTION

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## BACKGROUND

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The Federal Crop Insurance Corporation (FCIC) is a Government-owned corporation created February 16, 1938 (7 U.S.C. 1501). FCIC is charged with providing an actuarially sound, cost-sharing insurance program for farmers to protect them against losses due to adverse weather and other unavoidable causes. FCIC's multiple peril crop insurance (MPCI) programs are administered by the Risk Management Agency (RMA). MPCI programs are jointly delivered by FCIC through RMA and privately owned cooperating reinsured companies.

RMA delivers MPCI programs under Standard Reinsurance Agreements (SRA) with reinsured companies. Reinsured companies perform quality control (QC) reviews on their MPCI delivery operations, as well as provide insurance marketing, underwriting, servicing, loss adjustment, and other functions. Reinsured companies share, on a limited basis, both profits and losses with FCIC. The reinsured companies sold about 97 percent of the total crop insurance premiums for the 1994 crop year.

RMA's national headquarters office is in Washington, D.C. The agency also maintains a national operations office in Kansas City, Missouri. RMA is responsible for (1) supervision of the FCIC; (2) administration and oversight of all aspects of all programs authorized under the Federal Crop Insurance Act (7 U.S.C. 1510 et seq), (3) other programs involving revenue insurance, risk management savings accounts, or use of futures markets to manage risk and support farm income which may be established under Federal law; and (4) other functions considered appropriate by the Secretary. RMA's Compliance Division periodically reviews each reinsured company to evaluate compliance with the SRA, procedural requirements, and applicable laws and regulations. The SRA requires reinsured companies to develop QC plans that conform with the guidelines and expectations stated in RMA Manual 14, "Guidelines and Expectations for Delivery of Multiple Peril Crop Insurance" (Revised December 15, 1994).

Manual 14 declares the fulfillment of reinsured companies' QC responsibilities provides assurance that MPCI programs are administered in accordance with the SRA and the Federal Crop Insurance Act of 1980. The manual states "The quality control program must provide assurances that procedures, systems, and programs are effective, adequate, are being used properly and follow FCIC approved policies and procedures." The manual also describes reinsured companies' QC responsibilities, in part, as internal audits of agent sales and servicing activities; loss adjuster crop appraisal, inspection, and servicing activities; MPCI policy issuance activities; and actual production history reviews.

Office of Management and Budget (OMB) Circular A-123, "MANAGEMENT ACCOUNTABILITY AND CONTROL" (June 21, 1995), provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls. The circular requires management to incorporate basic management controls in the strategies, plans, guidance, and procedures that govern their programs and operations. Circular A-123 provides general and specific standards for management controls, all of which apply to FCIC's MPCCI programs.

## OBJECTIVES

monitored and evaluated reinsured companies' QC operations.

The objectives of our audit were to determine: (1) the adequacy of RMA's Manual 14 QC requirements for MPCCI policy sales and loss adjustments; (2) if reinsured companies complied with the QC requirements, and (3) if RMA effectively

## SCOPE

Our audit included reviews of the 1995 QC processes at 2 of 19 privately owned reinsured companies operating under a 1995 SRA with FCIC. One of the selected reinsured companies was the largest provider of MPCCI policies in the nation and accounted for about 20 percent of MPCCI premium sales. MPCCI premium sales for 1995 at the two companies were about \$496 million of about \$1.5 billion in total MPCCI sales. This represents about 32 percent of 1996 total MPCCI sales, including imputed premiums for catastrophic risk coverage. Indemnities paid through these two reinsured companies for 1995 losses totaled over \$541 million, or about 35 percent of all 1995 MPCCI indemnities; their respective loss ratios were 1.11 and 1.05. We judgmentally selected the reinsured companies based primarily on the size of the companies' operations and their location, relative to the audit control point. Although we performed audit tests to evaluate the companies' QC processes, we did not perform tests to evaluate the companies' overall management control structures. We conducted our audit tests during calendar year 1997.

We performed audit tests at the headquarters offices of the reinsured companies in Council Bluffs and West Des Moines, Iowa. We also visited judgmentally selected regional and divisional offices of the reinsured companies in Iowa, Nebraska, North Carolina, and Texas. Our reviews included evaluation of the reinsured companies' QC processes and compliance with RMA Manual 14. We determined if the companies' QC structure provided a reliable control over MPCCI policy sales and loss claims. We also evaluated the effect of the reinsured company's QC operations on the quality of work performed by agents and loss adjusters. We analyzed the companies' organizational structures to identify lines of authority and responsibility which were vulnerable to potential conflicts of interest. In addition, we evaluated the effectiveness of the companies' QC reviews of claims in excess of \$100,000.

The audit was conducted in accordance with Government Auditing Standards.

## METHODOLOGY

To accomplish our audit objectives, we visited the national offices of the two selected reinsured companies to obtain an understanding of their QC processes and organizational structures. This included interviews of company managers and employees responsible for QC, insurance sales, and claim operations. We also reviewed the reinsured companies' documentation on procedural requirements.

We reviewed company and RMA data files to ascertain sales agent identification (ID) numbers and other identifying information. We attempted to obtain similar information about the companies' loss adjusters, but succeeded at only one of the two companies visited (see Issue I in the Findings and Recommendation section of this report). We reviewed RMA information on judgmentally selected MPCI policies, related loss claims, sales agents, and loss adjusters, for identification and verification purposes.

We visited judgmentally selected regional and area offices of the reinsured companies to interview managers, supervisors, and other employees of the company to gain an understanding of how company procedures were implemented at those levels of the organization. We also interviewed selected sales agents, loss adjusters, and their respective supervisors. The offices visited were judgmentally selected on the basis of potential conflicts of interest identified during our analyses of RMA databases and reinsured company records.

In addition, we visited two RMA Compliance Offices to discuss RMA's compliance review methodologies and results at the two selected offices.



# FINDINGS AND RECOMMENDATIONS

## I. QC SYSTEMS NEED TO HELP EVALUATE PROGRAM DELIVERY AND INTEGRITY

Reinsured companies' QC systems were not used effectively as controls to help improve program delivery, ensure program integrity, or to measure and report on MPCCI program performance. These conditions occurred, in part, because the SRA did not contain provisions to ensure that QC processes were properly established and effectively applied. Also, RMA did not effectively monitor reinsured companies' QC activities and results to ensure the companies' QC systems produced meaningful results. As a result, RMA program officials cannot rely on reinsured companies' QC review systems to assure effective implementation and administration of FCIC reinsurance programs.

The reinsured companies' QC systems are an integral part of RMA's overall management control structure for providing reasonable assurance that MPCCI assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Although the QC systems we reviewed generally complied with the SRA and Manual 14, our audit disclosed conditions which showed the reinsured companies' QC operations and RMA's oversight of QC operations did not play a significant role in providing the assurance required of management controls. This deficiency was not reported in the agency's 1996 Federal Managers' Financial Integrity Act statements. We identified three weaknesses overall in MPCCI QC processes: (1) inadequate data collection, maintenance, and reporting requirements; (2) ineffective oversight of QC operations by RMA; and (3) ineffective controls over potential conflict of interest situations.

### OPERATIONAL REQUIREMENTS NEED STRENGTHENED

#### FINDING NO. 1

to effectively validate and improve program delivery operations. One company implemented MPCCI operational procedures which were not consistent with RMA's Manual 14. As a result, we concluded that neither RMA nor the reinsured companies developed effective QC processes to help protect the Government's interest during MPCCI program delivery operations or help ensure the integrity of the programs.

The reinsured companies did not adequately collect, maintain, or report information needed to produce meaningful QC results. Neither the 1995 SRA nor RMA procedures required the companies to do so. The companies we visited focused on compliance with the SRA and RMA procedural requirements rather than developing QC systems which could be used

OMB Circular A-123 states:

**"Management controls are the organization, policies, and procedures used to reasonably ensure that (i) programs achieve their intended results; (ii) resources are used consistent with agency mission; (iii) programs and resources are protected from waste, fraud, and mismanagement; (iv) laws and regulations are followed; and (v) reliable and timely information is obtained, maintained, reported and used for decision making."**

The circular's "Reasonable Assurance and Safeguards" standard states:

**"Management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Management controls developed for agency programs should be logical, applicable, reasonably complete, and effective and efficient in accomplishing management objectives."**

The 1995 SRA required reinsured companies to retain records regarding premiums and indemnities for at least 3 years following their respective final adjustment. The SRA did not require retention of records pertaining to organizational structure, key personnel and contractor responsibilities and assignments, or other information needed to evaluate the effectiveness of the reinsured companies' QC processes or management control structure.

- a. Company A Did Not Maintain Basic Information Needed to Operate an Effective QC System. The company did not have a record keeping system that could be used to identify all persons who performed MPCCI loss adjustments during the 1995 insurance year or all the claims adjusted by specific adjusters. A company representative provided four different listings of loss adjusters for the 1995 insurance year; each list contained different names and a different total number of adjusters. Company officials later agreed they could not compile a list of claims worked by each adjuster during 1995.

The officials also stated that claims adjusted by individual adjusters could be identified through travel expense claims for mileage expenses to and from claim sites; the MPCCI policy number or claim number should be included with the expense claim. Our review of expense claim documentation disclosed the information was not always complete or accurate. Company officials later agreed that travel expense claims were not a reliable source for identifying all the losses worked by a particular adjuster.

The company also could not provide our auditors with key information on oversight and supervision of loss adjusters. Officials stated that the nature of the crop insurance business made geographic boundaries temporary; claims supervisors must help each other when different areas are affected by conditions which generated a large number of claims. As a result, static or permanent areas of responsibility were not practical. This also held true when assigning loss adjusters to supervisors; although claims supervisors had certain loss adjusters generally assigned to them, actual supervisory assignments were changed to accommodate large numbers of losses in some areas. Officials stated that claims supervisors initially retained information on the loss adjusters assigned to them until the end of the insurance year or until losses were cleared. The supervisors then deleted assignment records to make room for the next year's

data; the company did not retain this information centrally. Although the SRA required the company to retain information on loss adjustments, it did not specifically require retention of information or summary files on each loss adjuster, their supervisors, or their assignments. As a result, we could not compile lists of all loss claims worked by selected loss adjusters, identify adjusters who were assigned to conduct or assist with particular claims, ascertain who assigned loss adjusters to specific claims, or who supervised the adjustment of particular claims.

The absence of such records prevented Company A and RMA from identifying trends or circumstances which would help RMA administer crop reinsurance programs and the reinsured companies to better manage loss adjustment operations. Neither the company nor RMA could identify loss adjusters (1) who were also sales agents for the reinsured company, another insurance agency, or competing agencies, (2) who adjusted or assisted in the adjustment of claims submitted by close relatives or business associates of the agent, the insured, or the adjuster, (3) who adjusted claims on policies sold by a particular agent or agency, (4) who consistently generated either large or small indemnity payments, (5) who repeatedly adjusted claims for producers with recurring losses, or (6) who performed the most loss adjustments, by crop or area. These same circumstances prevented our auditors from evaluating company A's efforts to control potential conflicts of interest.

- b. Sales Agent and Loss Adjuster ID Codes Were Not Used As Controls. Company B did not use sales agent and loss adjuster ID numbers effectively to improve MPCCI program performance or to help protect the integrity of MPCCI programs. Sales agents and loss adjusters sometimes obtained more than one ID number, including a company manager who sold MPCCI policies directly to the public. Company B also did not effectively use the ID numbers to prevent and detect conflicts of interest. This occurred, in part, because RMA did not require the companies to use ID numbers for these purposes. The agency also did not require the companies to establish a single, unique ID code for each sales agent and loss adjuster. As a result, RMA and the reinsured companies missed opportunities to prevent potential and real conflicts of interest situations and to detect them once they occurred (see Finding Nos. 4 and 5). In addition, the lack of reliable identification records at Company A hampered our efforts to obtain sufficient, reliable information for our planned audit procedures.

OMB's "Reasonable Assurance and Safeguards Standard" requires management controls to provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. The controls developed for programs should be logical, applicable, reasonably complete, and effective and efficient for accomplishing management objectives.

In our opinion, this standard cannot be met without a reliable system to prevent and detect potential conflicts of interest. That is, a means to match agents to the policies they sold and loss adjusters to the claims they worked, in addition to ensuring the two functions are not performed by personnel in personal or professional conflicting situations. The 1995 SRA did not require a single unique ID number for each agent and adjuster.

Company B developed and maintained a database of agent ID numbers and adjuster ID codes. We used the database to identify agents and loss adjusters employed or contracted by Company B. We also used the database to identify policies sold by selected agents and claims worked by selected loss adjusters. Company B permitted sales agents to have more than one agent ID number. Some agents obtained different ID numbers for different sales office locations and used the same or similar personal/business information. Other agents used different spellings for their names, nicknames, and/or different addresses. We also found agent ID numbers and adjuster codes which were issued to business entities, rather than to specific sales agents or adjusters, and some numbers issued without any name at all. Our review of Company B's database disclosed:

- over 10,000 sales agent ID numbers in the 1995 database;
- 27 agent ID numbers were listed for business entities, such as insurance agencies, rather than for specific individuals;
- 19 agent ID numbers were listed without a name;
- sales agents were sometimes listed with more than one agent ID number; one agent apparently had 40 or more ID numbers;
- 1 regional vice president had 6 agent ID numbers;
- less than 1,000 loss adjuster ID codes were maintained in the database;
- 36 loss adjuster ID codes were listed for business entities rather than to individuals; and
- 33 loss adjusters were listed with more than one ID code.

Note that our auditors were able to identify these conditions only because Company B developed reliable sales agent and loss adjuster databases. More significant deficiencies were apparent at Company A, but the company's incomplete records precluded effective analysis of the data.

- c. Company B Implemented Procedures Which Were Not Consistent With RMA Requirements. The company developed internal MPCII operating procedures to interpret RMA requirements for its employees and contractors, but the procedures were not consistent with RMA Manual 14 requirements. RMA approved the procedures, as a part of the company's plan of operations, apparently without ensuring the procedures were consistent with Manual 14. As a result, the company and its employees and contractors may believe they were authorized to deliver MPCII programs in a manner that was not consistent with RMA requirements.

We compared Company B's procedures to Manual 14 and found that RMA requirements were either missing or incorrect in at least nine operational areas. The areas included annual production histories, civil rights, corrective actions, customer complaints, loss adjustment, professional proficiency, summary reports, suspected fraud cases, and training. As an example, the company's procedures did not include the guidance provided in Manual 14 for use by loss adjusters when production records were questionable.

Another example pertained to training issues disclosed during audit tests. The company's procedures listed the minimum training for sales agents as 5 hours per year; RMA's Manual 14 required 6 hours per year. We reviewed training documents at four of the company's division offices and found that 106 sales agents within the 4 regions did not receive the minimum 6 hours training. We attributed this to the lack of adequate controls by both the company and RMA. The company's faulty procedures may also have had an impact on the agents' training. Although we could not establish a clear loss to the Government for the training deficiencies, we noted the total potential liability on MPCl policies was over \$21 million.

A company official stated the 5 hour training requirement was a typing error and the company actually required 6 hours as stated in Manual 14. The official also stated the company's internal procedures complied with RMA requirements because RMA had approved the cited procedures as part of the company's plan of operations. Company managers, employees, and contractors need a clear understanding of RMA requirements. Program delivery requirements and expectations cannot be clearly conveyed through incomplete or conflicting procedures. We recognize that certain characteristics of RMA's requirements may not be suited to all reinsured companies' operations. However, RMA and the affected company should negotiate workable solutions within the confines of the SRA rather than the agency authorizing procedures inconsistent with program requirements.

### **RECOMMENDATION NO. 1a**

Require reinsured companies to retain the information and records necessary to perform competent evaluations of QC processes for the 3-year period required for all records pertaining to premiums and indemnities. This should include the

means to identify and produce summary reports on (1) the loss claims worked by each loss adjuster as either the primary or assistant loss adjuster; (2) the loss adjusters assigned to each claims supervisor, including the period of assignment; and (3) the MPCl policies sold under the direction of each sales supervisor.

#### **RMA Response**

The agency's written comments (see Exhibit A) show the agency concurred with our finding and agreed these records are necessary to conduct competent evaluations of QC processes. The agency incorporated the requirements into Manual 13 effective for 1998.

#### **OIG Position**

We agree with the management decision for Recommendation No. 1a.

### **RECOMMENDATION NO. 1b**

Require reinsured companies to adopt RMA procedural requirements without modification or provide more effective controls over the process used to approve procedural changes by reinsured companies. At a minimum, the controls

should provide assurance that procedures modified by the companies meet an agreed-to minimum standard of performance before they are approved by RMA for implementation.

## RMA Response

The agency concurred with our finding and stated that corrective action was included in Manual 14 and the 1998 SRA. The response stated minimum guidelines were established for company QC processes and modification of reinsured companies' procedural standards for QC and training shall not be approved.

## OIG Position

We agree with the management decision for Recommendation No. 1b.

### MORE EMPHASIS NEEDED ON EVALUATING QC EFFECTIVENESS

Although RMA compliance reviews tested reinsured companies' compliance with the SRA and supplemental procedures, the reviews did not include an evaluation of the overall integrity and effectiveness of QC operations. RMA did not establish an effective oversight function to monitor the progress of the companies' QC operations. An RMA compliance official stated the agency attempted to schedule company-wide reviews of reinsured companies, including QC operations, every

## FINDING NO. 2

3 years. The reviews were generally applied to QC operations to test compliance with quantifiable features of QC operations, such as training hours and the number of QC reviews conducted on the work of each agent and adjuster. Compliance reviews were not designed to evaluate the capability of QC operations to produce usable results, improve program delivery, or assure program integrity.

OMB Circular A-123 advises:

**"Management accountability is the expectation that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs, and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law."**

Our examination of the 1995 SRA and RMA QC requirements disclosed RMA did not provide for the following features.

- Periodic QC Status Reports. The SRA did not require reinsured companies to report on the progress and results of QC operations throughout the insurance year. This permitted reinsured companies to perform QC reviews months after losses occurred and after field evidence deteriorated. In our opinion, it also prevented RMA from effectively monitoring QC operations.
- Annual QC Error Rates. The SRA did not require reinsured companies to calculate and analyze annual QC error rates. Error rates are necessary for program managers to measure program performance and results for individual reinsured companies and for MPCI programs overall. RMA and the reinsured companies could use statistically valid sampling methods to formulate meaningful nationwide and company-wide error rates, in addition to error rates for specific program activities, locations, agencies, contractors, and individuals.

- Prevention and Detection of Potential Conflicts of Interest. Although certain potential conflicts of interest are specifically prohibited by the SRA, RMA did not require reinsured companies to establish specific controls which would effectively prevent or detect potential conflicts of interest (see finding Nos. 4 and 5).
- Periodic RMA Evaluation of QC Systems. The SRA did not provide for periodic RMA evaluation of the effectiveness of reinsured companies' QC systems or of the overall effectiveness of QC processes for MPCCI programs. The SRA provided for RMA to test compliance of the reinsured companies to stated requirements, but did not provide for tests to determine if QC operations produced the intended results.
- Implementation of Corrective Actions. The SRA did not require RMA to monitor the progress of corrective actions taken by reinsured companies on QC review results. Effective monitoring is necessary to ensure that corrective actions are properly planned and effectively carried out.

In our opinion, these conditions demonstrated the QC process has not evolved into an effective and efficient system to enhance MPCCI programs and protect the Government's interests. Strengthening this management control function would serve to improve the overall performance and integrity of MPCCI program delivery operations.

## **RECOMMENDATION NO. 2a**

Implement a reporting system to monitor the timeliness and progress of reinsured companies' QC review activities and the progress of corrective action on QC review results.

### **RMA Response**

The agency concurred with this finding and recommendation. The response provided documentation that the agency had already implemented corrective action requiring reinsured companies to prepare annual summary reports detailing their QC review results by April 30, 1999.

**OIG Position**

We agree with management decision for this recommendation.

**RECOMMENDATION NO. 2b**

Consult with statistical experts to develop statistically reliable QC error rates for each reinsured company and all reinsured companies as a whole. This should be accomplished by requiring reinsured companies to uniformly

calculate and report annual QC error rates to RMA based on statistically verifiable QC review results.

**RMA Response**

The agency agreed with this finding and recommendation. The response showed RMA has required reinsured companies to develop statistically valid QC error rates by April 1999. RMA also plans to develop an overall QC error rate, based on the QC results of all reinsured companies, by November 1999.

**OIG Position**

We agree with the management decision for Recommendation No. 2b.

**RECOMMENDATION NO. 2c**

Consult with industry partners and implement a workable methodology to periodically evaluate the effectiveness of reinsured companies' QC processes and related reporting functions. The methodology should include verification

of summary reports and error rates, as well as independent and objective evaluations on reinsured companies' methods for implementing and maintaining QC operations.

**RMA Response**

The agency's written comments stated agreement with this finding and proposed a plan to evaluate the effectiveness of reinsured company QC processes using coordinated compliance reviews and RMA evaluation of reinsured companies' annual QC summary reports. These actions were scheduled for implementation by May 1999.

**OIG Position**

The agree with the management decision for this recommendation.



## II. MISSED OPPORTUNITIES TO PREVENT AND DETECT POTENTIAL CONFLICTS

Reinsured companies did not use QC operations as a management control to prevent and detect potential or real conflicts of interest that arise during routine MPCCI program delivery operations. Although other controls could also be established to manage situations which are potentially conflicting, the SRA and Manual 14 did not provide adequate guidance or procedural requirements to ensure the companies prescribed adequate controls to detect and prevent potential conflicts of interest. The reinsured companies also did not independently establish such controls. An effective QC process should have exposed the vulnerability of MPCCI programs to potential and real conflicts of interest to RMA officials prior to our audit. This weakness was not reported in the agency's 1996 Federal Managers' Financial Integrity Act statements.

OMB's Circular A-123, Separation of Duties and Supervision standard, states:

**"Key duties and responsibilities in authorizing, processing, recording, and reviewing official agency transactions should be separated among individuals. Managers should exercise appropriate oversight to ensure individuals do not exceed or abuse their assigned authorities."**

MPCCI programs are funded by the U.S. Department of Agriculture through a partnership with FCIC and the reinsured companies. As a result, MPCCI program transactions are "official agency transactions" as stated in the standard, whether the action is performed by FCIC, RMA, or reinsured company personnel operating under an SRA.

The circular's Delegation of Authority and Organization standard states:

**"Managers should ensure that appropriate authority, responsibility, and accountability are defined and delegated to accomplish the mission of the organization, and that an appropriate organizational structure is established to effectively carry out program responsibilities. To the extent possible, controls and related decision-making authority should be in the hands of line managers and staff."**

We concluded RMA, the crop insurance industry, and the two reinsured companies we reviewed recognized the vulnerability of MPCCI programs to potential conflicts of interest. The 1995 SRA and National Crop Insurance Services' (NCIS) Loss Adjuster's Handbook specifically prohibited commingling certain sales, service, and loss adjustment activities.

The 1995 SRA, Section V, Part F, states:

**"The company may not permit its sales agents, local agency employees, sales supervisors, or any spouse or family member residing in the same household as any such sales agent, local agency employee, or sales supervisor to adjust losses, or supervise, or otherwise control loss adjusters, nor to participate in the determination of the amount or cause of any loss nor to verify yields of applicants for the purpose of establishing any insurance coverage or guarantee, if the eligible crop insurance contracts**

involved are sold or serviced through the sales agent, \* \* \* local agency, any competing agency, or by any agent or local agency supervised by the sales supervisor."

The 1995 Loss Adjuster's Manual (NCIS - Issued May 1995), Part III, page 3, states:

"Loss adjusters cannot engage in sales, service, or administration of any MPCCI policy. The adjuster must not adjust any claims which are sold by any member of the adjuster's family or of the family of an employee of the adjuster, or any party the adjuster has a marital or financial interest with."

Neither RMA nor company officials implemented appropriate action to identify and control conflict of interest situations. Our review disclosed potential conflicts in both reinsured companies' delivery of MPCCI programs. The conflicts involved several facets of MPCCI program delivery and QC operations, and included sensitive sales and loss adjustment activities, contractors, competing agencies, and company managers, supervisors, and employees.

### **SUPERVISORS ASSIGNED CONFLICTING DUTIES AND RESPONSIBILITIES**

#### **FINDING NO. 3**

One of the two reinsured companies reviewed did not separate MPCCI policy sales supervisory responsibilities from those for loss adjustments. Twenty-two of 42 sales supervisors and 22 of 51 claims supervisors supervised both sales agents and loss adjusters. The claims supervisors had direct control over loss adjustments on the policies sold by agents whom they also supervised. Combined supervisory sales and loss adjustment responsibilities present a conflict between a supervisors' sales goals and the same supervisors' loss adjustment responsibilities. Personnel responsible for supervising MPCCI sales should not also be in a position to influence the amount of indemnities disbursed on those sales. This conflict developed because the SRA permitted the combined positions if the sales supervisors' compensation was not determined on a percentage of sales. As a result, the supervisors' conflicting responsibilities and authorities unnecessarily increased the vulnerability of MPCCI programs to waste, loss, and misuse.

The 1995 SRA required the separation of supervisory sales and loss adjustment responsibilities. Company A delegated both sales and loss adjustment responsibilities to over 40 percent of its sales supervisors. We compared lists of the company's 51 claims supervisors with a list of 42 sales supervisors. The comparison showed that 22 of the 42 sales supervisors were also listed as loss adjustment supervisors. A company official stated the company did not believe these dual roles created a problem because the SRA permitted the practice if the supervisors' compensation was not based on a percentage of sales.

We believe the combined supervisory responsibilities created an environment which could encourage supervisors to increase insurance sales by compromising the integrity of loss adjustments. For example, a sales supervisor may wish to improve the overall MPCCI sales of his staff; believing that higher indemnity payments encourage potential policyholders to buy the company's MPCCI policies, the supervisor may encourage his/her adjusters to relax the interpretation of key loss adjustment factors and restrictions to increase indemnity payments and thereby attract more customers.

The condition was further weakened by the fact that 7 of the 22 sales/claims supervisors also sold MPCCI policies directly to the public as sales agents for the company (see Finding No. 5 for details). This provided additional incentive for the combined sales supervisor/claims supervisor/sales agents to influence claims adjustments through subordinate loss adjusters. We could not determine the number of sales agents or loss adjusters reporting to the 22 supervisors because the company did not maintain records of 1995 staffing assignments (see details in Finding No. 1).

### RECOMMENDATION NO. 3

Require reinsured companies to separate supervisory responsibilities for claims adjustment and insurance sales activities. Compensating controls (such as required periodic reviews by headquarters staff) should be established

where small staffing levels in some areas may make this impractical. RMA should also require reinsured companies to address this issue in their plan of operations for QC reviews.

#### RMA Response

The agency's written response stated RMA did not agree with this recommendation. The response indicated the 1998 SRA permits general supervision of certain activities, including training, servicing, underwriting, and loss adjustment. However, all quality control reviews must be conducted by ... an unbiased person who was not involved in establishing the guaranteed, or adjusting the loss, or the sale or supervision of sales for the policies reviewed.

#### OIG Position

The agency's comments do not address the weakness presented in our finding; i.e., the conflict caused by one person supervising both sales and loss adjustment activities for individual MPCCI policies. We also wish to point out the supervisory activities noted in their response did not include combined supervision of sales and loss adjustment duties. Again, we acknowledge some circumstances, such as limited staffing levels, may prevent adequate separation of sales and loss adjustment duties and responsibilities. However, these situations should be managed through compensating controls. To reach a management decision for this recommendation, RMA needs to implement the recommended corrective action or provide an alternative action that addresses the weakness reported.

### CONFLICTS IN SALES AND LOSS ADJUSTMENT PERSONNEL CONTINUE

#### FINDING NO. 4

The reinsured companies did not establish adequate controls to ensure loss claims were not adjusted by persons with a potential conflict of interest, including sales agents who sold the policies, agents for competing agencies, and agents who were close relatives or business associates of the adjusters. We identified eight sales agents and six contracted marketing representatives (MR) with potential conflicts of interest at one reinsured company. As a result, RMA

and the reinsured companies cannot provide reasonable assurance that program assets were adequately safeguarded against waste, loss, or unauthorized use.

The agents and MR's were in potential conflict of interest situations because either they or a close relative adjusted or assisted in the adjustment of claims on a total of 128 MPCCI policies which they either sold or assisted in the sale. Indemnities totaling about \$677,700 were paid for claims on 89 of the 128 policies. The 1995 SRA specifically prohibited sales agents from adjusting losses and both companies had written policies which prohibited the practice. However, RMA did not ensure the prohibition was effective or potential conflicts of interest were prevented or detected.

- a. Sales Agents as Loss Adjusters. We identified 41 sales agents at Company A who were authorized both to sell MPCCI policies as agents and to adjust claims as loss adjusters. We reviewed the MPCCI travel expense vouchers submitted for reimbursement of loss adjustment activities and determined that 8 of the 41 agents were in conflict of interest situations. The following table summarizes the result of our review.

	<u>W</u>	<u>X</u>	<u>Y</u>	<u>Z</u>
<b>Agent A</b>	7	7	0	\$80,463
<b>Agent B</b>	52	41	11	61,650
<b>Agent C</b>	3	2	1	27,108
<b>Agent D</b>	2	2	0	23,251
<b>Agent E</b>	3	2	1	3,805
<b>Agent F</b>	1	1	0	3,005
<b>Agent G</b>	1	1	0	181
<b>Agent H</b>	1	0	1	0
<b>Totals</b>	<u>70</u>	<u>56</u>	<u>14</u>	<u>\$199,463</u>

*W = No. of 1995 policies sold by the agent and the agent adjusted or assisted in the adjustment of a loss claim on the policy.*  
*X = No. of "conflict" policies with paid indemnities.*  
*Y = No. of "conflict" policies with no indemnities paid.*  
*Z = Total indemnities paid on "conflict" policy claims.*

Agent B claimed mileage for 1995 loss claims on 52 MPCCI policies she had sold as an agent. The company disbursed \$61,650 in indemnities for 41 of the 52 claims; none were paid on the 11 remaining claims. A company official agreed the agent had been reimbursed for travel expenses to adjust or assist in the adjustment of claims from policies sold by the agent. We contacted the agent in Kansas and she confirmed she had assisted another adjuster on loss claims for policies she had sold as an agent. She stated in 1997, the company prohibited her from adjusting claims in nearby counties where she would be considered an agent of a competing agency, including claims on policies she herself had sold. She also commented the restriction was unfair because it was difficult for her to make a living without the income from loss adjustments and lost opportunities for leads on additional sales.

We concluded Company A did not establish sufficient controls to ensure sales agents did not adjust losses on policies they had sold. The company did not use loss adjuster ID codes. A company official stated the company maintained records of the claims each adjuster worked in a database, but did not have the resources to retrieve the information at the time of our audit. The only alternative source identified for this information were the travel expense claims submitted by loss adjusters for reimbursement of travel expenses. As a result, we could not design a meaningful sample to determine the frequency of

occurrence or the total indemnities placed at risk by permitting sales agent to be involved with loss adjustments on claims for policies they also sold.

- b. Marketing Representatives Used in Conflicting Roles. Company A also did not establish controls to ensure that MR's, who were used primarily to assist with sales and servicing MPCCI policies, did not also adjust claims on the policies for which they or their agency, or a competing agency, were involved in the sale. Although the company prohibited MR's from engaging in the conflict situations, it did not establish effective controls to detect or prevent the MR's from doing so. We identified seven MR's who were involved in the adjustment of losses in conflict of interest situations. The conflict of interest situations affected indemnities totaling over \$478,000 on 58 policies. Due to Company A's lack of central or summary records on claims adjustments, we could not perform adequate tests to determine the overall scope of this weakness.

An official who managed the MR's in 1995 provided a list of MR's working for Company A in 1995; the list included 71 MR's in 22 States. The official explained that MR's were employees of a subsidiary of Company A and contracted by the company to assist their agents service policies. MR's were paid on a per diem basis or by commission. At least 48 of the 71 MR's were also loss adjusters for Company A.

The 1995 SRA specifically prohibited sales agents from adjusting losses on claims for MPCCI policies sold by themselves, their agencies, or competing agencies. The company recognized the potential for conflicts between the MR's sales and servicing obligations and their separate loss adjustment work. As a result, Company A added a conflict of interest section to the standardized MR contract prohibiting the MR's from participating in certain potential conflict situations. One company official stated the company had issued the MR's ID numbers to help control potential conflict of interest situations. However, the ID numbers were deleted at the end of the insurance year and could not be retrieved for verification during our review.

We reviewed the list of MR's and compared the names on the list with known loss adjusters for Company A and found that 48 of the 71 MR's had adjusted losses for Company A. We judgmentally selected 12 of the 48 adjuster/MR's for review. Our selection was based, in part, on high mileage claims reported by the MR for loss adjustments.

We found 7 of the selected MR's had either adjusted or assisted in the adjustment of claims on 58 MPCCI policies which were either sold by the agencies where the MR assisted sales agents or were sold by competing agencies. We also found two of the selected MR's were claims supervisors for Company A, in addition to their MR status. One of the two MR/claims supervisors was among the seven MR's who adjusted 1995 losses. A total of \$478,251 in indemnities was paid on losses for the 58 policies identified during our review.

	<u>W</u>	<u>X</u>	<u>Y</u>	<u>Z</u>
MR-01	8	1	7	\$245,612
MR-02	11	3	8	165,374
MR-03	16	5	11	38,951
MR-04	6	3	3	15,823
<u>1/</u> MR-05	15	11	4	12,491
MR-06	1	1	0	
MR-07	1	1	0	0
<b>Totals</b>	<u><b>58</b></u>	<u><b>25</b></u>	<u><b>33</b></u>	<u><b>\$478,251</b></u>

W = No. of policies adjusted by the MR where the MR serviced the policy or serviced policies for the agency that sold the policy or serviced policies sold by an agency within the same city; i.e., a competing agency. (Column X+Y=W)  
X = No. of "conflict" policies with no indemnities paid  
Y = No. of "conflict" policies with paid indemnities  
Z = Total indemnities paid on "conflict" policy claims  
1/ = A husband and wife; one of whom was an MR and both adjusted losses.

- c. Claims Were Adjusted on Policies Sold by Competing Agencies. Loss adjusters worked claims on policies that were sold by competing insurance agencies. RMA did not require Company B to establish reliable controls to ensure agent/adjusters did not adjust claims on policies sold by competing agencies. RMA and the reinsured companies recognized the potential conflicts which may arise from permitting agent/adjusters to work loss claims on policies sold by their competitors. These conflicting situations could potentially result in either larger or smaller indemnities than were justified by the circumstances of the losses, depending on how the adjuster might wish to use the adjustments to his/her best advantage. Company B's records showed that 15 agents adjusted 290 claims which resulted in disbursement of indemnities totaling over \$1 million. The policies for all 290 claims were sold by just 56 sales agents, 6 of whom were located in 1 county.

We concluded RMA did not require Company B to establish reliable controls to ensure agent/adjusters did not adjust claims on policies sold by competing agencies. The SRA specifically prohibited sales agents from adjusting claims on policies sold by competing agencies. RMA Manager's Bulletin 96-058 (issued in 1996) clarified the definition of competing agencies as an agency in a county or adjoining county where the agent sold MPCII policies.

We compared Company B listings of the loss adjusters and sales agents in four States (Iowa, Missouri, Nebraska, and Texas). We identified 19 persons who sold MPCII policies and adjusted losses on MPCII policies for Company B. We also identified the States and counties where the 19 sales agents/loss adjusters were located and compiled a listing of the locations where the agent/adjusters adjusted loss claims. We compared the locations of the agent/adjuster with those of the claims and determined that 15 of the 19 agent/adjusters had adjusted claims on policies sold by competing agencies.

In our opinion, RMA should require reinsured companies to compare the sales and servicing personnel for MPCCI policies to those involved with adjusting losses on the policies, before indemnities are paid. In order to accomplish this, the companies must first identify and record all participating personnel. In most instances, this would include sales agents and assistants, primary and assistant loss adjusters, supervisory personnel, and other employees or contractors who may influence sales information and loss determinations.

#### RECOMMENDATION NO. 4

Consult with officials from reinsured companies and the crop insurance industry to establish effective controls for providing reasonable assurance that potential conflicts of interest between sales and loss adjustment personnel are timely detected, recorded, properly controlled, and prevented from recurring. The agency should also require reinsured companies address this issue in their plans of operations. Effective controls for these purposes can be established economically and effectively using current electronic and ADP technologies available to reinsured companies.

#### **RMA Response**

The agency did not concur with this recommendation. The agency proposed alternative corrective actions which would (1) facilitate discussions with reinsured companies and the industry regarding timely detection and prevention of potential conflicts of interest and (2) include recommendations from the RMA re-engineering project as an objective in developing criteria for a coordinated compliance review program.

#### **OIG Position**

Our findings disclosed examples of both real and potential conflicts of interest which should have been prevented by the reinsured companies or timely detected once they occurred. Our report also presented evidence that RMA and the reinsured companies already recognized the potential harm that conflicting personal and professional relationships could inflict on MPCCI policy sales and loss adjustments. In our opinion, RMA should properly address the finding and recommendation and take appropriate action to protect the integrity of MPCCI programs.

The introduction of OMB Circular A-123 states:

**"Management accountability is the expectation that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs and mitigating adverse aspects of agency operations, and assuring that programs are managed with integrity and in compliance with applicable law."** This means RMA managers need to provide reasonable assurance that MPCCI programs are administered with sufficient integrity to prevent and detect potential conflicts of interest which can cause significant harm to the program.

In order to reach a management decision for this recommendation, the agency needs to implement the recommended corrective action or develop acceptable alternatives that address the control weaknesses.

## IMPROVED CONTROLS NEEDED FOR KEY EMPLOYEES

### FINDING NO. 5

Both reinsured companies participated in employment practices which could result in conflicts of interest. The companies permitted managers and employees to sell MPCCI policies directly to the public and adjust loss claims without controls to ensure the managers and employees did not use their knowledge and authorities to their own advantage or to circumvent program requirements. One company's

organizational structure also commingled management authority for claims and QC at the divisional level. The SRA did not prohibit these practices, nor require the company to implement compensating controls to reduce the increased vulnerability of potential employee conflicts of interest. The lack of controls to prevent or detect potential conflicts involving employees increased the vulnerability of MPCCI programs to waste, loss, and misuse of program assets.

- a. Employee Sales, Service, and Loss Adjustment - Company A. A review of certain Company A agent and adjuster ID numbers disclosed at least 43 corporate officers and employees who held agent ID numbers during the 1995 insurance year. Twenty-four of the 43 employees actually sold MPCCI policies under these agent ID numbers. Although the 1995 SRA specifically prohibited loss adjusters from engaging in the administration sales, and service of MPCCI policies, it did not prohibit the companies from using company personnel to sell MPCCI policies or to work loss claims as loss adjusters. The company authorized 24 employees to adjust claims in addition to their primary responsibilities. None of the 24 employees were contractors and they included:

- 18 Employees Who Only Supervised Loss Adjusters
- 2 Who Supervised Both Sales Agents and Loss Adjusters
- 2 Who Supervised Sales Agents Only
- 1 Regional Vice President
- 1 National Claims Auditor
- 24 Total Employees Authorized as Loss Adjusters

Twenty-four other employees sold MPCCI policies for the reinsured company and included:

- 7 Employees Who Supervised Sales Agents and Loss Adjusters
- 5 Who Supervised Sales Agents Only
- 3 Vice Presidents
- 3 Who Supervised Loss Adjusters Only
- 2 Contracted MR's
- 1 Sales Director
- 1 National Coordinator for MR's
- 1 Assistant Manager for Specified Perils
- 1 Computer Programmer
- 24 Total Employees with Sales Agent ID Numbers

The 24 agent/employees sold 1,677 MPCCI policies during the 1995 insurance year. We judgmentally selected 5 of the 24 employees and determined the 5 employees sold 1,056 of the 1,677 policies. Premiums collected on the policies totalled over \$1,450,000; total loss indemnities paid exceeded \$1,500,000.



We believe a prohibition against reinsured company employees selling MPCCI policies may not be either necessary or practical. However, RMA and the companies should recognize the vulnerability of the policies and claims adjustments to waste and abuse and establish appropriate controls to prevent or detect improper authorizations and activities.

- b. MPCCI Sales by Management - Company B. Two officials operating under Company B's SRA sold MPCCI policies directly to producers without adequate compensating controls or the knowledge of key corporate officials. Neither RMA nor the company prohibited insurance sales by managers. One manager stated his policies belonged to long-time customers from the manager's former period as a sales agent. The second manager cited an approaching deadline for insurance sales and stated he was involved in the sales only as a convenience to the customers. In our opinion, there is a real potential for a conflict of interest in these instances because the managers were in a position to influence liability and loss adjustment determinations made by their subordinates. Although we found no indications that the managers had influenced any decisions made on the policies, both RMA and the company need to recognize the increased vulnerability of such policies. In an effort to please, a subordinate employee may make a questionable determination on a policy sold by a manager, without the manager's knowledge or desire.

The "Separation of Duties and Supervision Standard" requires the separation of key duties and responsibilities for authorizing, processing, recording, and reviewing transactions. Further, appropriate oversight should ensure that individuals do not exceed or abuse their authorities. We believe this should be interpreted by RMA to either prohibit sales by key reinsured company managers or require the companies to develop meaningful compensating controls to ensure the integrity of MPCCI program delivery.

The "Reasonable Assurance and Safeguards Standard" requires management controls to provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. The controls developed for programs should be logical, applicable, reasonably complete, and effective and efficient for accomplishing agency objectives.

One manager was the vice president in charge of a regional office covering three large agricultural States. We found he sold two 1995 and four 1996 MPCCI policies. Although three of the policies were randomly selected for QC review, none were flagged for mandatory review as required. Also, none of the six policies incurred payable losses during the cited insurance years. The second manager was owner, president, and chief executive officer of a smaller reinsured company operating under the primary reinsured company's SRA. This manager sold at least seven 1995 MPCCI policies. Our review showed indemnities paid on the 1995 policies, if any, were not significant. However, we also noted the seven policies were not flagged for mandatory QC review or subject to any compensating controls.

The company's national QC manager assured us he was not aware the managers had made direct MPC I policy sales. He also stated the managers would be instructed to end their involvement with the cited policies and the company would include coverage of this issue during future internal reviews.

- c. Commingled Claims and QC Authority. QC reviews on loss adjusters' work at Company B were not always managed, supervised, or conducted by the independent personnel needed to assure objective QC review results. Reviews were sometimes performed by claims supervisors who were also responsible for the work reviewed. We found 9 of the 12 company's division offices had one person perform the dual and conflicting roles of Claims Manager and QC Manager. Our review at one division office disclosed 7 claims supervisors who conducted QC reviews on claims adjusted by 12 of the loss adjusters they supervised. The supervisors performed 61 of the 77 QC reviews (about 80 percent) completed for the 12 loss adjusters during the 1995 insurance year.

The SRA and RMA procedures did not prohibit supervisors from conducting QC reviews on their staff's work and the company permitted these practices. Also, officials at Company B did not believe separation of the supervisor or management duties for claims and QC functions was necessary. We believe a conflict arises because claims managers/supervisors may have more reason to ignore or discount QC review results than to fully and accurately report them. The delegation of supervisory and QC review responsibilities to one employee compromised the integrity of the QC process.

Management should anticipate that QC reviews on loss adjustment activities may disclose weaknesses in claims management and supervision, as well as in claims actions performed by the adjusters. Thus, independent and objective QC reviews can only be managed, supervised, and performed by individuals who are not involved in the activities under review. We recognize the size of the divisions' staffs may require combining various management functions. In circumstances where staffing limitations prohibit adequate separation of duties, the company must apply appropriate controls to ensure that QC reviews are conducted and recorded by independent and objective staff, and the results of the reviews are fully and accurately reported.

## RECOMMENDATION NO. 5a

Prohibit direct MPC I policy sales by reinsured company officials and employees or require reinsured companies to establish effective controls to prevent inappropriate influence by the officials and employees on MPC I insurance sales,

service, and loss adjustment determinations.

### RMA Response

The agency's written response states RMA does not concur. RMA agrees reinsured companies should establish effective controls to prevent inappropriate influence by company officials and employees regarding MPC I insurance sales, service, and loss adjustment determinations.

**OIG Position**

To reach a management decision, the agency needs to develop a plan to ensure reinsured companies apply effective controls to prevent and/or detect company officials and employees from exercising inappropriate influence over MPCCI policy decisions. The plan should also include the timeframe for implementation.

**RECOMMENDATION NO. 5b**

Consult with QC experts and reinsured company officials and develop mandatory organizational structures which will effectively protect the integrity of MPCCI programs and QC processes. This should include amended SRA provisions requiring

reinsured companies to separate management functions for QC from those for claims and sales and to develop compensating controls to ensure independent and objective QC operations where such separation is not practical. The controls needed to compensate for commingled QC responsibilities should include periodic evaluation as to the adequacy of QC reviews, records, and reports by an independent evaluator, with clearly defined evaluation objectives and tests. The evaluations should be conducted with appropriate frequency using approved evaluation methodologies.

**RMA Response**

RMA does not agree with this recommendation. The response states the agency agrees reinsured companies should maintain compensating controls to ensure independent and objective quality control operations. RMA does not believe requiring companies to develop mandatory organizational structures is within "the scope of SRA negotiations." The response states the procedural requirement in Manual 14 that quality control reviews must be conducted by objective and unbiased persons precludes the need to develop mandatory organizational structures.

**OIG Position**

We believe the agency needs more effective controls to ensure quality control reviews are not performed, supervised, or managed by employees who also supervise or manage the work under review. We pointed out that the agency's procedural requirements were not sufficient to ensure the conflicting roles were adequately separated. To reach a management decision, RMA needs to develop mandatory organizational structures or alternative controls which will provide reasonable assurance that quality control reviews are not conducted, supervised, or managed by employees who also supervise or manage the work subject to the review.

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# EXHIBIT A - RMA RESPONSE TO THE DRAFT REPORT



Risk  
Management  
Agency

Stop Code 0801  
1400 Independence Ave., SW  
Washington, DC 20250

TO: Edwin D. Linderman  
Regional Inspector General for Audit  
Office of Inspector General

THROUGH : James R. Ebbitt  
Assistant Inspector General  
Office of Inspector General

FROM: Kenneth D. Ackerman *Kin. A* JUL - 1 1998  
Administrator

SUBJECT: OIG Audit Report No. 05099-2-KC - Quality Control for Crop Insurance  
Determinations

This is in response to your memorandum dated May 4, 1998, regarding the subject official draft audit report. The Risk Management Agency (RMA) responds as follows:

## OPERATIONAL REQUIREMENTS NEED STRENGTHENED

### RECOMMENDATION NO. 1a

*Require reinsured companies to retain the information and records necessary to perform competent evaluations of QC processes for the 3-year period required for all records pertaining to premiums and indemnities. This would include the means to identify and produce summary reports on (1) the loss claims worked by each loss adjuster as either the primary or assistant loss adjuster; (2) the loss adjusters assigned to each claims supervisor, including the period of assignment; and (3) the MPCl policies sold under the direction of each sales supervisor.*

### RMA Response:

**RMA concurs.** These records are necessary to conduct competent evaluations of quality control processes.

Companies are now required in Manual 13 to report loss adjuster identification numbers on all claim forms. Furthermore, companies are required to maintain records depicting the loss adjusters assigned to each claims supervisor and the MPCl policies sold under the direction of each sales supervisor. The three year document retention period, as required in the Standard Reinsurance Agreement (SRA), ensures that information is available to perform competent evaluations of company quality control processes pertaining to premiums and indemnities.

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# EXHIBIT A - RMA RESPONSE TO THE DRAFT REPORT

Edwin D. Linderman

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## RECOMMENDATION NO. 1b

*Require reinsured companies to adopt RMA procedural requirements without modification or provide more effective controls over the process used to approve procedural changes by reinsured companies. At a minimum, the controls should provide assurance that procedures modified by the companies meet an agreed-to minimum standard of performance before they are approved by RMA for implementation.*

RMA Response:

RMA concurs. *Corrective action has been taken.* Item 24(c) of the Plan of Operations states, "Describe the process by which the Company will implement the quality control plan required in Manual 14." The 1998 SRA and Manual 14 require that a company's quality control process meet the minimum guidelines. Approvals of modifications to company procedural standards for the conduct of quality control and training are not allowed.

## MORE EMPHASIS NEEDED ON EVALUATING QC EFFECTIVENESS

### RECOMMENDATION NO. 2a

*Implement a reporting system to monitor the timeliness and progress of reinsured companies' QC review activities and the progress of corrective action on QC review results.*

RMA Response:

RMA concurs. *Corrective action has been taken.* Manual 14, Section 7, Quality Control Guidelines, A., 13, states, "[Companies] Prepare an annual summary report detailing the results of each review category required. The written summary report will include, at a minimum, the requirements outlined below and will be forwarded by April 30 following each crop year (first report will be due April 30, 1999) to the Deputy Administrator for Compliance, Risk Management Agency". The report will identify, by contract number, the following information: crop, name and title of the person who conducted the review, the date the review was completed, the type of review conducted, discrepancies or incorrect information detected, monetary effects, and/or the effect on the APH.

### RECOMMENDATION NO. 2b

*Consult with statistical experts to develop statistically reliable QC error rates for each reinsured company and all reinsured companies as a whole. This should be accomplished by requiring reinsured companies to uniformly calculate and report annual QC error rates to RMA based on statistically verifiable QC review results.*

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# EXHIBIT A - RMA RESPONSE TO THE DRAFT REPORT

Edwin D. Linderman

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## RMA Response:

**RMA concurs.** Manual 14, Part 7, 3(a), page 11, requires insurance companies to develop statistically valid error rates for inclusion in Annual Summary Reports. RMA, in consultation with statistical experts, will use the company error rates to develop quality control error rates for each reinsured company and reinsured companies as whole. As stated in response to recommendation 1b, Annual Summary Reports are due to RMA by April 30, 1999. Development of quality control error rates will take approximately 6 months after receipt of the first Annual Summary Report submissions. *As such, implementation of corrective actions is anticipated in November 1999.*

## RECOMMENDATION NO. 2c

*Consult with industry partners and implement a workable methodology to periodically evaluate the effectiveness of reinsured companies' QC processes and related reporting functions. The methodology should include verification of summary reports and error rates, as well as independent and objective evaluations on reinsured companies' methods for implementing and maintaining QC operations.*

## RMA Response:

**RMA concurs.** One result of the RMA Re-engineering Project was a recommendation that delivery partner relationships be enhanced. This enhancement includes the development of policies, procedures and criteria for RMA and delivery partners for a coordinated compliance review program. The Project also recommended the establishment of an open forum for RMA and delivery partners to communicate issues and concerns and the implementation of target reviews and compliance incentives. RMA will incorporate these recommendations in the development of a coordinated quality control review program.

In addition, RMA's evaluation of the companies' quality control program will be accomplished during the review of the Annual Summary Reports. Specifically, RMA will evaluate the reports to verify error rates, as well as rendering objective and independent determinations on reinsured companies methods for implementing and maintaining quality control operations. As indicated previously, the first Annual Summary Reports are due April 30, 1999. *As such, the estimated time frame for implementation of corrective actions is May 1999.*

## SUPERVISORS ASSIGNED CONFLICTING DUTIES AND RESPONSIBILITIES

### RECOMMENDATION NO. 3

*Require reinsured companies to separate supervisory responsibilities for claims adjustment and insurance sales activities. Compensating controls (such as required periodic reviews by headquarters staff) should be established where small staffing levels in some areas may make*

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# EXHIBIT A - RMA RESPONSE TO THE DRAFT REPORT

Edwin D. Linderman

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*this impractical. RMA should also require reinsured companies to address this issue in their plan of operations for QC reviews.*

RMA Response:

**RMA does not concur.** The 1998 SRA provides for a general supervisor who may supervise activities associated with the general administration of the crop insurance program in an area. The activities may include training, servicing, underwriting and loss adjusting. However, all quality control reviews must be conducted by objective an unbiased person who was not involved in establishing the guarantee, or adjusting the loss, or the sale or supervision of sales for the policies reviewed.

## CONFLICTS IN SALES AND LOSS ADJUSTMENT PERSONNEL CONTINUE

### RECOMMENDATION NO. 4

*Consult with officials from reinsured companies and the crop insurance industry to establish effective controls for providing reasonable assurance that potential conflicts of interest between sales and loss adjustment personnel are timely detected, recorded, properly controlled, and prevented from recurring. The agency should also require that reinsured companies address this issue in their plans of operations. Effective controls for these purposes can be established economically and effectively using current electronic and ADP technologies available to reinsured companies.*

RMA Response:

**RMA does not concur.** RMA will facilitate discussions with reinsured companies and the crop insurance industry regarding the timely detection and prevention of potential conflicts of interest. One result of the RMA Re-engineering Project was a recommendation that delivery partner relationships must be enhanced. This enhancement includes the development of policies, procedures and criteria for RMA and delivery partners for a coordinated compliance review program, including the timely detection and prevention of conflict of interest situations. RMA will include this recommendation as an objective in developing the criteria for a coordinated review program. As such, inclusion of conflict on interest issues in the plan of operations will be depend on the outcome of future delivery partner communications.

## IMPROVED CONTROLS NEEDED FOR KEY EMPLOYEES

### RECOMMENDATION NO. 5a

*Prohibit direct MPC I policy sales by reinsured company officials and employees or require reinsured companies to establish effective controls to prevent inappropriate influence by the officials and employees on MPC I insurance sales, service, and loss adjustment determinations.*

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# EXHIBIT A - RMA RESPONSE TO THE DRAFT REPORT

Edwin D. Linderman

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**RMA Response:**

RMA does not concur. RMA agrees that reinsured companies should establish effective controls to prevent inappropriate influence by company officials and employees regarding MPC I insurance sales, service, and loss adjustment determinations. RMA, however, does not object to an employee of a company being licensed to sell and service crop insurance contracts. In an era of reduced administrative and operating subsidies, RMA believes that our reinsured companies, as other property and casualty insurance companies have, will consider the benefits of direct marketing through electronic media. By law, an “independent” private licensed sales agent may or may not be involved in the selling and servicing of a crop insurance contract.

**RECOMMENDATION NO. 5b**

*Consult with QC experts and reinsured company officials and develop mandatory organizational structures which will effectively protect the integrity of MPC I programs and QC processes. This should include amended SRA provisions requiring reinsured companies to separate management functions for QC from those for claims and sales and to develop compensating controls to ensure independent and objective QC operations where such separation is not practical. The controls needed to compensate for commingled QC responsibilities should include periodic evaluation as to the adequacy of QC reviews, records, and reports by an independent evaluator, with clearly defined evaluation objectives and tests. The evaluations should be conducted with appropriate frequency using approved evaluation methodologies.*

**RMA Response:**

RMA does not concur. RMA agrees that companies should maintain compensating controls to ensure independent and objective quality control operations where separation between management, sales, and claims operations is not practical. RMA will include this recommendation as an objective in developing the criteria for a coordinated quality control review program. However, developing mandatory organizational structures for reinsured companies is beyond the scope of the SRA negotiations. Manual 14, Part 7, Quality Control Guidelines states “All quality control reviews must be conducted by objective and unbiased persons, who were not involved in establishing the guarantee or adjusting the loss, or in the sales or supervision of sales for the policies reviewed.” This compensating control precludes the need to develop mandatory organizational structures and adequately addresses the recommendation.

We appreciate having the opportunity to respond to the report.