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Office of Inspector General
Southwest Region

Audit Report

Risk Management Agency Crop Loss and Quality Adjustments for Aflatoxin-Infected Corn

Report No. 05601-15-Te
September 2008



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250



Sep 30, 2008

REPLY TO

ATTN OF: 05601-15-Te

TO: Eldon Gould
Administrator
Risk Management Agency

ATTN: Michael Hand
Deputy Administrator for Compliance

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

SUBJECT: Crop Loss and Quality Adjustments for Aflatoxin-Infected Corn

This report presents the results of the subject audit. Your written response to the draft report, dated September 3, 2008, is included as exhibit E with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant Finding and Recommendation sections of the report.

Although we partially agree with the planned corrective actions, management decisions could not be reached on Recommendations 1, 2, and 3. Documentation and actions needed to reach management decisions for these recommendations are described in the OIG Position section of the report.

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 implementing the recommendation for which management decision has not been reached. Please note that the regulation requires a management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Performance and Accountability Report.

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

Executive Summary

Risk Management Agency - Crop Loss and Quality Adjustments for Aflatoxin-Infected Corn (Audit Report 05601-15-Te)

Results in Brief

Aflatoxin is a toxic byproduct of the fungus *Aspergillus* that under certain environmental conditions—hot and wet weather—can infect grain harvests, including corn. The Risk Management Agency (RMA) provides crop insurance that insures corn producers against the economic losses they may suffer due to Aflatoxin infecting their harvests. These insurance policies are not handled directly by RMA, but instead are administered by private insurance companies known as approved insurance providers (AIP). AIPs underwrite insurance policies to protect producers from the risks associated with growing crops, including losses they may incur due to an Aflatoxin infection, and adjust any claims that may occur. RMA, in turn reinsures the AIPs against losses they may suffer. The Office of Inspector General (OIG) initiated this audit to determine if indemnities paid to Texas corn producers in crop year (CY) 2005 were based on reasonable determinations of producers' Aflatoxin-related losses. We also reviewed the adequacy of RMA's management controls over these indemnities and the adequacy of any changes in those controls for CYs 2006 and 2007.

Nationwide, in CY 2005, AIPs paid indemnities for Aflatoxin-infected corn totaling \$27 million, of which \$17.5 million was paid to Texas producers. Of the 2,453 CY 2005 claims for Aflatoxin-infected corn in Texas, we identified 2,033 claims where the value established for infected corn was extremely low—\$.25 or less per bushel. We then selected 397 claims for more detailed review.

For 394¹ of these claims, we found that the AIPs accepted extremely low values (from \$.08 to \$.25) for infected corn, but that producers later sold this infected corn for prices between \$.80 and \$2.30 per bushel—between 5 to 28 times the value used to calculate the indemnity. This occurred because the AIPs failed to ensure that their adjusters were using reasonable values for the producers' corn when they calculated losses. As a result of using these excessively low market values, the AIPs paid Texas producers indemnities totaling \$15.9 million.

Due to this situation, producers were able to receive far more than the value of their corn, even if it had not been infected with Aflatoxin. One producer, for instance, received an indemnity of \$106,059² and sold his corn for \$105,707. He thus received a total of \$211,766 for his corn crop. Since the market value of his corn—if it had been uninfected—was only \$121,538, this

¹ The remaining three claims were settled at \$1.90 to \$1.95 per bushel.

² This was the portion of the indemnity payment related to the Aflatoxin loss and does not include the loss from production.

producer received 74 percent more than what his production would have been worth if there had been no Aflatoxin infection.

Although AIPs did not fulfill their obligation to determine reasonable prices for Aflatoxin-infected corn, RMA's policies for CY 2005 provided them with little guidance for establishing reasonable market values. For CY 2007, RMA developed a new method for calculating the indemnity producers could receive if their corn became contaminated with Aflatoxin, and published those procedures in the *Loss Adjustment Manual (LAM)*. These new procedures no longer required AIPs to determine the market value of corn infected with Aflatoxin but instead allowed producers to receive a payment based on 50 percent of their production.

RMA's revised *LAM* procedures eliminated the need for AIPs to determine the value of corn crops infected with Aflatoxin, but we question if they will be more effective in determining producers' actual losses. If producers determine that the market value of their crop is greater than the payment that they could elect to receive based on 50 percent of their production, they can receive this payment and still sell their crop at whatever price the market would bear.

If the purpose of the program is to indemnify producers for actual losses due to contamination of their corn, OIG maintains that the only certain way to determine producers' actual losses is to indemnify them using the price they receive at final disposition of the corn, when the corn is sold. To demonstrate this point, we recalculated a sample of 20 producers' indemnities using the CY 2005 *LAM* procedures (referenced herein as the CY 2005 *LAM*), the CY 2007 *LAM* procedures (referenced herein as the CY 2007 *LAM*), and our suggested procedures for determining losses based on price at the point of final disposition. Under the CY 2005 *LAM*, the total indemnities paid to these producers was \$406,636; under the CY 2007 *LAM*, the total indemnities paid would be \$236,590; and under our proposed revision, based on the actual sales price, the total indemnities paid would be \$166,580. Our proposed change reduces indemnities by \$240,056 (59 percent) compared to the CY 2005 *LAM*, and \$70,010 (30 percent) compared to the CY 2007 *LAM*. See exhibit D for the illustration of the 20 sampled producers' indemnities.

At the exit conference, RMA officials stated that they are proposing to revise its CY 2007 *LAM* procedures for CY 2009 to compute payments using a graduated scale based on the level of Aflatoxin contamination. Using the graduated scale that RMA has proposed for CY 2009, the total indemnities paid would have been \$183,720. This revision would have reduced indemnities paid in CY 2005 by \$222,916 and would still result in \$17,140 more than the indemnities paid using the actual sales value. We concluded that even though the proposed graduated scale would more closely

approximate actual losses, using the sales price received at final disposition would still yield payments that were more accurate and reflective of the producers' losses. Therefore, we are recommending that RMA authorize the AIPs to pay a preliminary settlement based upon the proposed graduated scale, but then require the AIPs to adjust the preliminary settlement upon final disposition of the crop.

Recommendations In Brief

We are recommending that RMA:

- Issue administrative findings to recover the improper payments resulting from the approximately \$15.9 million in CY 2005 Aflatoxin claims in Texas that were calculated using market values of \$.25 or less per bushel.
- Revise the current claims adjustment *LAM* procedures to require that AIPs utilize the proposed graduated discount factors to compute a preliminary settlement for losses due to Aflatoxin contamination and then adjust the preliminary settlement based on the final sales price or market values determined for the crop upon final disposition, withholding final settlement of claims until the date of final disposition.
- Notify all AIPs that the current *LAM* procedures require that claims with Aflatoxin levels exceeding levels set by the Federal or State Government or any other regulatory body cannot be finalized until the final disposition of the crop.

Agency Response

RMA does not fully agree with the recommendations. According to the agency, there was never any question of denying the reinsurance for any indemnity based on under-market prices, and it was in the process of evaluating each disputed claim and issuing administrative letters to the applicable insurance providers. RMA also noted that it delayed working on these determinations to ensure that the administrative actions would not complicate the investigation of any criminal activity. RMA asked that the recommendation be withdrawn to remove the administrative responsibility of reporting the status of recovering the improper claims to OIG and the Office of the Chief Financial Officer.

RMA believes that claims should not remain open until the actual sales price of the contaminated crop becomes known but suggests that a flat rate be paid to producers using a graduated scale based on the level of contamination. The graduated scale would be used instead of computing a preliminary settlement for losses and withholding final settlement until final sales of the contaminated grain.

Although the agency agrees that an informational bulletin should be issued to all AIPs to remind them of the requirement to use RMA-approved procedures, the agency does not agree that it needs to specify in its notice that current regulations require claims involving highly contaminated corn to be held open until final disposition.

OIG Position

OIG specifically acknowledges in the report that RMA officials first recognized and reported to OIG that CY 2005 claims for Aflatoxin-infected corn were improperly settled by loss adjusters. OIG coordinated with RMA as to the investigation of any criminal activity, and RMA participated in meetings with the Assistant U.S. Attorney, where it was discussed that the available evidence did not meet the test for a criminal case. In May 2007, OIG Investigations declined the matter. During our review, OIG identified the monetary discrepancies between the “bid prices” and the actual sales price of the Aflatoxin-infected grain by obtaining sales documents evidencing the final disposition of the contaminated corn. Therefore, OIG cannot agree with RMA’s request to withdraw the recommendation, but believe these questioned costs must be timely resolved.

OIG continues to believe that the only accurate and equitable way of computing losses from Aflatoxin contamination is to base that computation on the price derived from the actual sale of the crop. Any interim economic hardship on the producer could be lessened by advancing a payment on the claim, which could later be adjusted. RMA also has not provided supportable evidence that there will be a material administrative burden for the AIPs by adopting OIG’s recommendation.

Finally, we maintain that RMA needs to notify all AIPs of its existing procedural requirement that claims involving highly contaminated grain be held open until the final disposition of the grain.

In order to accept management decision on the recommendations, RMA needs to provide OIG with the information requested in the OIG Position section following each recommendation.

Abbreviations Used in This Report

AIP	Approved Insurance Provider
CY	Crop Year
FDA	Food and Drug Administration
FSA	Farm Service Agency
<i>LAM</i>	<i>Loss Adjustment Manual</i>
OCFO	Office of the Chief Financial Officer
OGC	Office of the General Counsel
OIG	Office of Inspector General
ppb	Parts Per Billion
RMA	Risk Management Agency
SRCO	Southern Regional Compliance Office

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Background and Objective

Background

The Federal Crop Insurance Corporation is a Government-owned corporation created to improve the economic stability of agriculture through a federally guaranteed system of crop insurance. The Federal Agriculture Improvement and Reform Act of 1996 authorized the formation of the Risk Management Agency (RMA), with its three divisions (Insurance Services, Product Development, and Risk Compliance), to handle the day-to-day operations of the Federal crop insurance program. The program provides producers with insurance coverage against crop failures due to crop disease, hurricanes, and other risks of production.

RMA administers Federal crop insurance programs by reinsuring policies sold through private insurance companies known as approved insurance providers (AIP). AIPs are responsible for selling and servicing crop insurance policies. The Standard Reinsurance Agreement is considered a cooperative financial assistance agreement between the Federal Crop Insurance Corporation and the insurance company named on the agreement. This agreement requires each insurance company or its managing agent to be in good financial standing and comply with laws of the State where it is domiciled and in States where its business is conducted. The AIP is responsible for complying with all of the provisions of this agreement. This would include, but is not limited to, actual production history calculations; adjustment of losses; and the verification of eligibility for insurance, acreage planted or prevented from planting, insurable shares, insurable causes of loss, or unit division.

A contract of insurance between the insured producers and the AIPs specifies provisions of the policy and the rights and responsibilities of the parties. These basic provisions are referred to as the “Common Crop Insurance Policy” and specify the basic terms and conditions for insurance coverage. RMA issues procedures (handbooks, manuals, memoranda, and bulletins) to provide guidance to the AIPs for the administration of the program. The *Loss Adjustment Manual (LAM)* provides the general loss adjustment procedures for adjusting crop losses for which the AIP is responsible. These *LAM* procedures allow the production of a crop to be adjusted downward if the quality of the crop is affected in a manner that is approved by that manual, such as infection by Aflatoxin. Producers are eligible for an indemnity payment if their quality adjusted production falls below their insured level. The amount of the quality adjustment is usually related to the Aflatoxin level present in the crop. Under the crop year (CY) 2005 *LAM*, the adjuster is responsible for ensuring that only usual, customary, and reasonable reductions in value are used. If the Aflatoxin level present in the crop exceeds

the Food and Drug Administration's (FDA) approved levels, then the use of the crop is limited.

The following table is an example of FDA's Center for Veterinary Medicine's action levels for maximum Aflatoxin contamination in animal feeds. The contamination level is expressed in parts per billion (ppb).

Class of Animals³	Feed	Aflatoxin Level
Finishing beef cattle	Corn and peanut products	300 ppb ⁴
Beef cattle, swine or poultry	Cottonseed meal	300 ppb
Finishing swine over 100 lb.	Corn and peanut products	200 ppb
Breeding cattle and goats, swine and mature poultry	Corn and peanut products	100 ppb
Immature animals	Animal feeds and ingredients, excluding cottonseed meal	20 ppb
Dairy animals, animals not listed above, or unknown use	Animal feeds and ingredients	20 ppb

RMA's Compliance Division is responsible for monitoring adherence to program provisions for both the producers and the AIPs that sell and service policies. RMA has six regional compliance offices located throughout the United States. These compliance offices protect the integrity of the crop insurance program by assuring compliance with crop policy terms and approved procedures; assessing program vulnerability, fraud, and program abuse; investigating alleged fraud and abuse; and recommending changes in policies, loss adjustment, farm service-related procedures, specific agreements, and contract services.

In CY 2005, insurance claims paid to Texas corn producers for Aflatoxin totaled about \$17.5 million. RMA's Southern Regional Compliance Office (SRCO) initiated an administrative review of these claims due to allegations that the market value of Aflatoxin-infected corn was intentionally understated at grain elevators for the purpose of increasing crop insurance payments to insured producers. SRCO obtained policy files from the insurance companies and created a database to summarize the claim information including the Aflatoxin levels of the grain and the bid prices used to adjust the claims. However, SRCO did not obtain the policyholders' final sales records for the Aflatoxin-infected corn, since they were not included in the policy files obtained from the AIPs.

In addition, allegations were made that loss adjusters working for AIPs operating in Texas during CY 2005 colluded to assign extremely low values to corn contaminated with Aflatoxin. These low values were established

³ Source: FDA's Industry Activities Staff Booklet, dated August 2000.

⁴ Texas allows up to 500 ppb to be blended down in accordance with special laws.

based on bids received from grain warehouse operators, and resulted in producers receiving higher indemnity payments.

On June 6, 2006, SRCO requested a meeting with the Office of the General Counsel (OGC) to discuss options and seek guidance on the allegations of intentionally understating bids for the purpose of increasing crop insurance payments. The allegations involved a number of AIPs as well as allegations of conspiracy by agents, adjusters, and producers to defraud the program. A meeting was held on July 26, 2006, involving officials from SRCO, OGC, Office of Inspector General (OIG) Investigations, and OIG Audit. Information was presented by SRCO and it was decided that the case should be presented to the Assistant U.S. Attorney.

On September 14, 2006, SRCO requested the assistance of the OIG, Southwest Region Investigations, to investigate the possibility that the prices were intentionally understated. After performing some preliminary fieldwork, OIG and SRCO staff met with the Assistant U.S. Attorney in December 2006. The Assistant U.S. Attorney stated that more evidence was needed in order to prove collusion in the setting of bid prices.

On May 30 2007, OIG's Southwest Region Investigations informed RMA's SRCO that it had found "no substantive evidence of criminal activity" and was therefore declining to pursue the matter further.

Objective

Our objective was to evaluate the adequacy of management controls over quality adjustments used in making indemnity payments on CY 2005 Aflatoxin-infected corn and the adequacy of any changes in those controls for CYs 2006 and 2007. Specifically, we determined whether indemnity payments on Aflatoxin-infected corn claims in Texas for CY 2005 were based on reasonable reductions in market value.

Findings and Recommendations

Section 1. AIPs Did Not Correctly Adjust for Losses

Finding 1

AIPs Failed to Verify Usual, Customary, and Reasonable Market Values for Aflatoxin-Infected Corn When They Settled Indemnity Payments

During our review of 397 judgmentally sampled CY 2005 Aflatoxin-infected corn claims, we found that for 394 claims AIPs accepted excessively low market values (ranging between \$.08 and \$.25 per bushel) to settle indemnity claims. Despite these low market values, we verified that the producers eventually received final disposition prices that were 5 to 28 times higher than the earlier accepted market values. Furthermore, based on our analysis of RMA's database of CY 2005 claims, we found that the AIPs paid indemnities on 2,033 of the 2,453 Aflatoxin-infected corn claims from Texas corn producers using excessively low market values. This occurred because the AIPs failed to properly determine whether adjusters were using reasonable values for the contaminated corn when they calculated producers' losses. Using these excessively low market values, AIPs paid Texas producers indemnities totaling \$15.9 million.

The CY 2005 *LAM* states that adjusters are responsible for calculating producers' losses as a consequence of Aflatoxin contamination using only a "usual, customary, and reasonable value."⁵ Also, the *LAM* procedures direct AIPs not to finalize claims until they are satisfied with all claim determinations, including the value of the crop, especially if the crop is given an extremely low value.⁶

Under *LAM* procedures, producers retain ownership of their corn even after they receive their indemnity payments. Producers normally sell their corn after the first of the year, when prices have risen from lower levels at harvest. We found that the sales prices received by producers were from 5 to 28 times higher than the value the AIPs had used to calculate the indemnity. In other words, due to the AIPs' reliance on unverified market values, Texas corn producers were able to benefit from the weakness in RMA's policies and procedures, and received far more than the economic value of their losses.⁷

As Table 1 shows, producer B—whose corn would have been worth \$121,538 if it had not been infected with Aflatoxin—was able to receive an indemnity of \$106,059 (attributed to Aflatoxin quality adjustment) and still sell his corn for \$105,707. This producer thus received a total of \$211,766 for his corn crop, which was 74 percent more than what his production would

⁵ RMA's CY 2005 *LAM*, par. 96H(5), dated 2005.

⁶ CY 2005 *LAM*, par. 67H.

⁷ See exhibit C.

have been worth if there had been no Aflatoxin infection. Table 1 illustrates the excess proceeds four producers received.

Table 1

Claimant	Unit Number	Total 2005 Indemnity	Aflatoxin ⁸ Indemnity	Sales Revenue	Aflatoxin Indemnity and Sales Revenue	Market Value of Noninfected Corn	Excess Proceeds
B	103	\$127,619	\$106,059	\$105,707	\$211,766	\$121,538	\$ 90,228
A	106	25,280	20,657	10,930	31,587	23,946	7,641
N	105	88,294	64,565	30,349	94,914	73,141	21,773
M	1010	4,268	4,268	15,543	19,811	9,814	9,997
Total		\$245,461	\$195,549	\$162,529	\$358,078	\$228,439	\$129,639

Our sample shows that these four producers received \$358,078 in revenue for corn that would have only been worth \$228,439 if it had not been infected with Aflatoxin. We concluded that the producers enriched themselves by an average of 57 percent beyond the value of an uninfected corn harvest.

AIPs Indemnified Producers' Aflatoxin-Infected Corn Using Extremely Low Values

When producers' corn becomes infected with Aflatoxin, they may be eligible for an indemnity for the economic loss they have suffered. In CY 2005, the *LAM* procedures required AIPs to calculate that indemnity according to how much the infected corn was worth compared to the corn's ordinary market value.⁹ AIPs were to establish, in accordance with the *LAM* procedures, "usual, customary, and reasonable values" for infected corn based on the best available local market value.¹⁰ Additionally, the *LAM* procedures directed AIPs not to finalize claims until they were satisfied with all claim determinations, including the value of the crop, especially if the crop was given an extremely low value.¹¹

During CY 2005, Texas corn producers experienced a widespread incidence of Aflatoxin in their crops. As producers were harvesting their corn and delivering it to their local grain elevators, loss adjusters, representing the AIPs, obtained samples of producers' harvest to determine how much Aflatoxin was present. Once they had determined how much Aflatoxin was

⁸ This column does not contain indemnity amounts attributed to production losses.

⁹ CY 2005 *LAM*, par. 96H(5).

¹⁰ CY 2005 *LAM*, par. 96H(5).

¹¹ CY 2005 *LAM*, par. 67H.

present in a given harvest, these adjusters were also responsible for determining the infected corn's value.

In order to determine the value of the Aflatoxin-infected corn, the loss adjusters used an ad hoc "bidding" process in which they called managers of major grain elevators in the area and asked them how much they would pay for a bushel of Aflatoxin-infected corn at that particular moment.¹² In some instances we found that elevators provided a written estimated value ("bid" sheet) but did not document the basis for the value. Based on this process, loss adjusters arrived at market values of \$.08 or \$.25 per bushel—extremely low values. Other than "bid" sheets, we found no documentation in the producers' claim file showing how the loss adjusters or the grain elevators determined these unusual market values as required by the *LAM* procedures.

In an attempt to verify these low values, we contacted the managers of these grain elevators and learned that they felt the loss adjusters pressured them to approximate a value for the Aflatoxin-infected corn. They also stated that these values were arbitrarily derived. Two of the three managers in North Texas stated that they believed that \$.08 or \$.25 per bushel was an unreasonable market value for the corn, but provided the bids because the third manager offered these prices. They argued that, if such low prices were real, producers could not economically harvest their corn, nor could elevators economically process it. During our review, we found no sales that occurred at \$.08 and only 12 transactions that occurred at the \$.25 price. The sales that occurred at the \$.25 level involved a grain elevator in South Texas that purchased grain contaminated at levels of 300 ppb or above. We found no sales occurred at that price in North and Central Texas, where many of the CY 2005 Texas Aflatoxin claims originated.

According to the AIPs, when they began processing CY 2005 claims with these excessively low market values, they met with RMA personnel to obtain guidance on how to handle such low values. AIPs contended that RMA's *LAM* procedures provided them little guidance in addressing situations where the indemnity calculations would produce such unusual results; namely, indemnity payments based on bids of \$.25 per bushel or less. AIPs stated that, as a result of this meeting, RMA directed them to work within the *LAM* procedures at their disposal. However, an RMA Oklahoma City Regional Office official countered that he advised AIPs that questionable low market values should not be used in lieu of holding the claim open until the final disposition price was known.

We found that AIPs did not accept the RMA Oklahoma City Regional Office official's advice or follow *LAM* procedures that they hold the claims open until the final disposition of the crop. Instead, AIPs processed the claims at

¹² Although we found the adjusters referred to the market values provided by elevator managers as "bids," this was a misnomer since these were not final disposition prices because the elevators did not buy, nor did the producers sell, the grain at these prices.

the low market values of \$.08 or \$.25. See Table 2 for examples of these excessively low market values.¹³

Table 2

Claimant	Unit Number	Value Used To Calculate CY 2005 Indemnity	Sales Price of Crop Upon Final Disposition	Difference
B	103	\$.08	\$2.07	\$1.99
A	106	\$.08	\$1.10	\$1.02
F	7.06	\$.25	\$1.87	\$1.62
Q	101	\$.08	\$2.00	\$1.92
K	10.00	\$.25	\$1.31	\$1.06
J	109	\$.08	\$1.60	\$1.52

Of the 394 claims that were settled using market values of \$.08 or \$.25 per bushel,¹⁴ we found that the insured producers actually sold their corn at prices between \$.80 and \$2.30 per bushel.¹⁵ These producers received final disposition prices between 5 to 28 times greater than the market values used to calculate the indemnity payments. These producers were able to benefit from a weakness in the program and were reimbursed at a value far beyond the economic value of their crop.¹⁶

Additionally, for corn with Aflatoxin levels over 300 ppb,¹⁷ LAM procedures require AIPs to calculate the producers' indemnity payment based on the final disposition (usually the sales price) of the contaminated corn, yet we found they failed to do so.¹⁸ Of the 2,033 claims that were settled using a market valuation of \$.25 or less, we identified 508 claims that AIPs were required to have held open until final disposition of the crops, but did not. Instead, on these 508 claims, AIPs finalized and paid improper indemnities totaling \$3.1 million.¹⁹

On May 9, 2007, OIG held a meeting with SRCO officials and informed them that information was obtained on the final sales price for the Aflatoxin-infected corn claims. This information clearly showed that the producers sold their crop for substantially more than the bid price used to adjust the claim. We also found that the AIPs involved had not obtained documentation substantiating the reasonableness of the low bids their adjusters used for adjusting the Aflatoxin-infected corn claims.

¹³ See exhibit B.

¹⁴ The other three indemnity payments were settled based on a per bushel value of \$1.90 to \$1.95. We considered the \$1.90 to \$1.95 per bushel value to be a reasonable market value and did not question the propriety of those three indemnity payments.

¹⁵ Typically, Texas corn producers harvest and store their production at grain elevators between August and October. Then that corn is sold after January of the following calendar year. The 397 judgmentally sampled indemnity payments fit this chronology.

¹⁶ See exhibit B.

¹⁷ FDA Center for Veterinary Medicine's action levels for maximum Aflatoxin contamination in animal feeds.

¹⁸ CY 2005 LAM, par. 96H(2).

¹⁹ The \$3.1 million is the amount paid for the 508 claims as reflected on RMA's claims database for CY 2005. Only a portion of the 508 claims was reviewed as part of the 397 claims we sampled.

In accepting these excessively low market values in settling these claims, the loss adjusters ignored normal marketing practices; typically, Texas corn producers harvest and store their production at grain elevators between August and October when corn prices are normally low. Then they sell their production after January of the following calendar year, when prices are normally higher. We found that after providing market values of \$.08 and \$.25 to the loss adjusters for Aflatoxin-infected corn during fall 2005, these same elevators had purchased that same infected corn at a price between \$.80 and \$2.30 per bushel. Final disposition records reveal that the grain elevators purchased the infected grain from the producers between January and April 2006.

We concluded that the AIPs did not fulfill their responsibilities for arriving at usual, customary, and reasonable values for Aflatoxin-infected corn.

RMA Adjusted its Policies and Procedures for Indemnifying Aflatoxin-Infected Corn

When RMA recognized how AIPs could fail to correctly apply its CY 2005 *LAM* for indemnifying producers with Aflatoxin-infected corn, the agency acted to eliminate this problem by developing new procedures for calculating indemnity payments when dealing with quality adjustments, including Aflatoxin. These procedures were put into effect for CY 2007.²⁰

RMA's CY 2007 *LAM* eliminated AIPs' need to conduct market surveys to determine the market values of infected corn. Instead, the new policies allow producers to elect to receive a payment based on applying a 50 percent discount factor to the producer's actual production, if Aflatoxin levels above 20 ppb are detected.^{21 22} This payment would be applied to all infected corn units that the producers elect to market, except corn infected with more than 300 ppb. Payment for Aflatoxin-infected corn over 300 ppb would continue to be adjusted based on its sales price.²³ RMA officials stated that they used 50 percent because the Farm Service Agency (FSA) uses this percentage in its disaster program for Aflatoxin-infected corn.

We used the CY 2005 claim data and recalculated the indemnity payments based on the changes in the CY 2007 *LAM*. We used this data to perform a comparison of indemnity amounts to show the effective reduction in

²⁰ RMA did not have any procedural changes in CY 2006.

²¹ The revised *LAM* procedures permit the producer to wait for up to 60 days to sell the crop and use that actual sales price to compute his loss. In that instance, the indemnity due is measured by the difference between the actual sales price and the insured's market price guarantee. The producer can also elect within that 60 day period to receive a flat payment based on the 50 percent discount factor.

²² Payment under the CY 2007 *LAM* is calculated in the following manner: (Guaranteed production – production to count) x producer's price selection x producer's share of the crop. "Guaranteed production" is the product of the producer's estimated yield x producer's reported acreage x producer's level of coverage. "Production to count" is the actual production x 50 percent discount factor.

²³ RMA's CY 2007 *LAM*, "Settlement of Claims," sec. 2b., par. 102.O, dated January 2007.

indemnity payments made by these changes in procedures.²⁴ Table 3 illustrates, in dollar terms, this reduction in indemnity payments with the changes in *LAM* procedures for CY 2007, as they compare with the procedures that existed for CY 2005.²⁵

Table 3

Claimant	Unit Number	Indemnity Paid Based on 2005 Regulations	Indemnity Payable Based on 2007 Procedures
B	103	\$127,619	\$76,456
N	105	88,294	57,113
L	303	16,713	5,394
E	109	29,250	12,647
Totals		\$261,876	\$151,610

We agree that RMA's CY 2007 *LAM* would significantly reduce indemnity payments, as the above table illustrates, and eliminate the need for AIPs to determine the market value of corn crops infected with Aflatoxin. However, we believe that the new *LAM* procedures will still allow the producers to receive an indemnity payment, retain possession of their corn, and later sell it at or near prices that they would have received had the corn not been infected with Aflatoxin. This same concern is reflected in an agency decision memo, dated October 13, 2006, addressed to the RMA Administrator. The memo stated that the CY 2007 *LAM* changes will not keep producers from receiving an indemnity payment based on the 50 percent discount factor and then selling their grain on the open market with little or no price discount.

Under both CYs 2005 and 2007 *LAM*, producers could receive an indemnity payment in addition to any proceeds from the sale of their corn. Our review showed that most producers sold their corn for little discount from the normal market price. As a result, a majority of our sampled producers received a greater economic gain from the indemnity and the sale of their Aflatoxin-infected corn than they would have if they had sold uninfected corn at normal market prices. Using the data from CY 2005 and applying that data to the CY 2007 *LAM*, we found similar problems in excessive payments as we found for our CY 2005 review. We concluded, therefore, that the revised CY 2007 *LAM* does not correct the essential problem with the quality adjustment for Aflatoxin-infected corn.

Based on this analysis, OIG proposes that the CY 2007 *LAM* be revised to use the final sales price of Aflatoxin-infected corn. Using the final sales price in the indemnity formula, adjusters could calculate indemnity payments that

²⁴ The data that were constant in the computations for CYs 2005 and 2007 include actual production, guaranteed production level, insured price coverage, market price of uninfected corn, and the producer's share of the crop. The data that varied between the two comparative computations were data elements such as the discount factor and the related production deficiency, which are components of the indemnity computation.

²⁵ See exhibit D.

equitably compensate producers for their losses. The sales price would more closely approximate market value than using the 50 percent discount factor.

To further illustrate the differences between the three procedures—the CYs 2005 and 2007 *LAM*, and our proposed revision—we recalculated 20 claims from our sample of 397 indemnified units. Table 4 below shows a comparison of the total indemnities paid for the 20 claims using the three methods.

Table 4

Crop Year	Total Indemnities for 20 Selected Producers	Difference From OIG Proposed Change	Percent Difference
2005 <i>LAM</i>	\$406,636	\$240,056	59%
2007 <i>LAM</i>	\$236,590	\$ 70,010	30%
OIG Proposed Sales Value Change	\$166,580	\$ 0	0%

OIG’s proposed change reduces indemnities by \$240,056 (59 percent), compared to the CY 2005 *LAM*, and represents a \$70,010 (30 percent) decrease in indemnity payments over the CY 2007 *LAM*. Exhibit D illustrates how the CYs 2005 and 2007 *LAM*, and our proposed change would affect these 20 claims on an individual basis.

RMA officials have also recently proposed replacing the 2007 *LAM* procedures with a graduated scale for CY 2009 and succeeding crop years. This graduated scale would compute probable losses based on the level of Aflatoxin present. While corn that tested at 300 ppb and above would continue to receive a discount factor of 50 percent, corn with lower levels of infection would be discounted between 10 and 40 percent. RMA officials stated that such indemnity computations will yield a reasonable measurement of the claimant’s loss without the need to wait until the final sale or disposition of the corn.

We recomputed our sample of 20 claims using the proposed graduated scale and compared it to both the current CY 2007 procedures and our proposed revision using the sales value. Table 5 below illustrates the difference in indemnity payments under the three methods.

Table 5

Crop Year	Total Indemnities for 20 Selected Producers	Difference From Agency Proposed Graduated Scale	Percent Difference
2007 <i>LAM</i>	\$236,590	\$52,870	22%
OIG Proposed Sales Value Change	\$166,580	\$17,140	10%
Agency Proposed Graduated Scale	\$183,720	\$ 0	0%

The agency’s proposed change reduces indemnities by \$52,870 (22 percent) compared to the current CY 2007 *LAM* procedures. Even though this new proposal is an improvement over current procedures, it still does not result in the same indemnities as if the claims would have been adjusted using the sales value. In order to help producers have access to the indemnity payments and not be forced to sell their crops, OIG suggests that the proposed graduated scale of discount factors could be used to calculate a preliminary settlement which could then be adjusted up or down based on the crop’s final disposition value.

RMA officials have objected to calculating indemnities for Aflatoxin corn based on its sales price because some producers do not choose to sell their corn. These producers instead feed that corn to livestock on their property. However, RMA officials did not provide us with definitive information on the number of producers who commonly feed their livestock infected corn. Thus, we were unable to evaluate the validity of this argument. However, since the producers never sold their crop and their economic loss could not be established, the proposed graduated scale of discount factors would have to be used as final adjustment of the claim for corn that is fed.

While we acknowledge RMA’s concerns with using the sales price to adjust claims, we disagree with them. If the purpose of the program is to indemnify producers when the presence of Aflatoxin adversely affects the ultimate sales price or their ability to market their corn, we feel that the program should only indemnify producers based on the final sales price. Moreover, existing procedures allow the AIPs to delay final settlement until the final disposition or sale of the crop. The AIPs were informed of this authority during meetings with RMA officials. While the AIPs did not elect to use this authority, the precedent exists for them to do so. To allow producers to receive their indemnity payments quickly, AIPs could use the graduated discount factors as a tool to calculate a preliminary settlement, which could then be adjusted based on the final disposition value.

In summary, we recommend that RMA change its *LAM* procedures so that the indemnity calculation is based on an accurate assessment of producers' losses, which is the sales price of their corn at final disposition or its market values when other uses apply. Also, we believe RMA needs to ensure that the AIPs implement effective management controls to ensure the proper handling of claims involving Aflatoxin-infected corn that exceeds action levels for maximum contamination in animal feed set by the Federal or State Government, or any other regulatory body.

Given the problems we found with the Aflatoxin indemnity payments, we are questioning the validity of any indemnity that was computed and paid based on a market value of \$.25 or less per bushel. The total of these claims in Texas for CY 2005 is \$15,951,016.

Recommendation 1

Issue administrative findings to recover the improper payments resulting from the approximately \$15,951,016 in CY 2005 Aflatoxin-infected corn claims for Texas that were calculated using market values of \$.25 or less per bushel.

Agency Response.

RMA does not agree with this recommendation. According to RMA's response, there was never any question of denying reinsurance for any indemnity based on under-market prices, and the agency states that it is in the process of evaluating each disputed claim and issuing administrative letters to the applicable insurance providers. RMA objects to the recommendation because "it gives the appearance that the idea of denying reinsurance was an original OIG proposal. . . . [I]t is RMA's position that . . . it is inappropriate [for OIG] to claim credit for monetary discrepancies" that the agency has already identified.

RMA also noted that it delayed working on these determinations to ensure that the administrative actions would not complicate the investigation of any criminal activity, which was what the agency requested when it referred the case for OIG's review.

RMA asked that the recommendation be withdrawn to remove the administrative burden of reporting the status and final disposition of each case to OIG and the Office of the Chief Financial Officer.

OIG Response.

OIG has made recommendations to improve how USDA administers indemnity payments to producers whose crops become infected with Aflatoxin to ensure that taxpayers' funds are used as efficiently as possible. Thus, the question of who "originated" the idea of denying reinsurance or

who should “claim credit” should not be a matter of argument and is not pertinent to the program weaknesses described in the report. Moreover, the audit report specifically notes that RMA officials *first* recognized and reported to OIG that CY 2005 claims for Aflatoxin-infected corn were improperly settled by loss adjusters.

When OIG began this review, RMA officials asked for our assistance in gathering evidence to support a definitive determination that such claims were indeed improper based on under-market pricing. The evidence that came to light—during the investigation and audit conducted by OIG—did not substantiate accusations of criminal activity. Ultimately, the decision not to pursue a criminal case was a legal decision made by the Assistant U.S. Attorney, who explained the burden of proof needed for a criminal case and how the available evidence did not meet that test. RMA officials attended this meeting with the Assistant U.S. Attorney in December 2006, and on May 30, 2007, OIG’s Investigations declined the matter. Thus RMA officials were aware an investigative report of criminal wrongdoing would not be issued.

While OIG acknowledges that RMA originally noted problems with CY 2005 Aflatoxin claims, we do not agree that the monetary discrepancies between “bid prices” used to adjust the claims and the actual sales price of the Aflatoxin-infected grain were already fully identified by the agency. OIG calculated these monetary discrepancies based on *sales* documents evidencing the final disposition of the contaminated corn. RMA had not obtained these documents and, in at least one instance, its requests for the documents from one of the grain elevators had been refused.

While RMA has acknowledged the need to seek repayment of a portion of the improperly paid indemnities, OIG’s recommendation seeks to capture those claims that were adjusted based on the low market values. RMA has requested that the recommendation be withdrawn due to the “administrative burden” involved in reporting the results of its actions to the Office of the Chief Financial Officer. However, OIG cannot agree to this request because these are questioned costs that must be timely resolved.

To reach management decision on this recommendation, RMA needs to continue with its plan to determine the deficiencies and improper payments relating to each Aflatoxin claim for CY 2005 in Texas and pursue recovery of the improper payments from the applicable insurance providers. Also, RMA needs to provide its estimated timeframe as to when these actions will be completed.

Recommendation 2

Revise the current claims adjustment *LAM* procedures to require that AIPs use the proposed graduated discount factors to compute a preliminary settlement toward the total indemnity payments for losses due to Aflatoxin contamination and adjust the payment based on the final sales price or market values determined for the crop upon final disposition.

Agency Response.

RMA does not believe that indemnity claims due to Aflatoxin contamination need to be based on the final sales price of the contaminated grain. Alternatively, for CY 2009, it is planning to compute those claims based on pre-established graduated discount factors. RMA believes that computing the claims on the final sales price of the grain would result in the following negative consequences for producers and insurance companies:

- 1) Valuing production based on a market value when a producer elects to feed or use the crop as silage, other than being sold, would be difficult.
- 2) Requiring producers to sell their Aflatoxin-infected production in order to receive a quality adjustment may actually cause more infected grain to enter the food chain.
- 3) Requiring producers to sell their Aflatoxin production may influence the market place and result in earlier than normal sales of grain.
- 4) Holding claims open for an extended length of time may create administrative burdens and inefficiencies for AIPs. If an advance payment is used, a claim may result in an overpayment causing AIPs to encounter difficulties in collecting the overpaid amounts, and resulting in (a) unrecoverable losses, (b) placing producers on the ineligible list, and (c) arbitration and litigation.

OIG Response.

Concerning the first point, the recommendation does not “require” producers to sell their Aflatoxin-infected production. Instead, it allows for the final determination to be made based either on the “final sales price” or “market values determined for the crop upon final disposition.” We acknowledge that in those cases where the crop is used for feed or otherwise not sold, the advance payment based on the graduated scale of loss, as currently proposed for 2009 by RMA, is a reasonable approach for determining the final payment on the claim.

Concerning the second point, again, the recommendation does not “require” producers to sell their Aflatoxin-infected production. Using CY 2005 as an illustration, if indemnities were based on the actual sales price of corn, the indemnities paid would have been significantly reduced. Thus, it is feasible that there would be a disincentive to sell the corn. Given that disincentive, producers might very well elect to feed it to their livestock and receive payment according to RMA’s graduated scale, which would serve as the final payment. Therefore, RMA’s contention that more Aflatoxin-infected corn would enter the market is a questionable argument.

As for the concern that designing the program in this way would “influence the market place,” OIG maintains that the very existence of any reinsurance program, such as the program for Alfatoxin-infected corn, already influences

the marketplace. By basing the indemnity on the sales price of infected corn—when such corn is sold—RMA will in fact be causing its program to follow more closely ordinary market forces. We do not agree that this proposal will necessarily result in “earlier than normal sales of grain.” Producers will be able to sell their grain when they want, and receive an indemnity based on what the marketplace is willing to offer. The producers’ true economic loss can only be determined at the time the corn is sold or disposed.

Finally, RMA has argued that this recommendation will result in claims being held open for an extended length of time, resulting in an administrative burden on the reinsurance companies. RMA’s response also expressed concern that adjustments to advanced payments might result in collection difficulties for the AIPs if the adjustment resulted in an overpayment on the claim. RMA has not provided supportable evidence that there will be a material administrative burden for the AIPs to make advance payments.

Therefore, we continue to believe a loss indemnity on Aflatoxin-infected crops should be based on the final sales price or market value of the crop upon final disposition.

To reach management decision on this recommendation, RMA either needs to develop and implement a system that will require insurance providers to withhold final settlement of Aflatoxin claims until the final sales price of the contaminated grain is known or provide evidence that the overall effect of using the sales value to compute the final settlement is minimal compared to using the graduated scale. We also need to be informed of the estimated time frame in which the recommended action will be completed.

Recommendation 3

Notify all AIPs that the current *LAM* procedures require that claims with Aflatoxin levels exceeding levels set by the Federal or State Government, or any other regulatory body, cannot be finalized until the final disposition of the crop.

Agency Response.

RMA partially agrees with this recommendation in that it plans to issue a bulletin to all AIPs notifying them of revised quality control adjustments for the 2009 crop year, and reminding them to use RMA-approved procedures when adjusting claims. However, RMA will not include the statement that the claim cannot be finalized until the final disposition of the crop, except in the case of a zero value.

OIG Response.

RMA’s objections to not finalizing claims for Aflatoxin corn under 300 ppb should not apply to such highly contaminated corn. For corn contaminated

with Aflatoxin above 300 ppb, *current* LAM regulations already state that claims should not be settled until the grain is sold, used, or destroyed.²⁶ As our report shows, some claims on such highly contaminated corn were settled prior to final disposition, which violates this RMA-approved procedure. By reminding each AIP of its obligation to use RMA-approved procedures, the agency would in effect be reminding AIPs not to finalize claims on such highly contaminated corn until the final disposition of the crop. We believe this reminder should be articulated to the AIPs clearly and explicitly.

To reach management decision on this recommendation, RMA needs to include in the bulletin a notification of the requirement that Aflatoxin claims involving corn contaminated beyond levels of 300 ppb should not be finalized until final disposition of the crop. We also need to be informed of the estimated time period in which the recommended action will be completed.

²⁶ CY 2005 LAM, par. 96H(2).

Scope and Methodology

To fulfill our objective we reviewed claim records for indemnities paid to Texas corn producers due to Aflatoxin contamination in CY 2005. Audit fieldwork was conducted in Texas from February 2007 to January 2008.

Indemnities paid for Aflatoxin-infected corn for CY 2005 totaled 3,720 claims for approximately \$27 million nationwide, of which 2,453 claims totaling approximately \$17.5 million were paid to corn producers in Texas, 64.8 percent of the total. Of the total indemnity payments paid to Texas producers, 2,033 claims totaling about \$15.9 million (or 90.8 percent) were calculated based on contaminated corn valued at \$.25 or less per bushel.

We interviewed RMA officials at the SRCO, in Dallas, Texas; at RMA's Product Management Office in Kansas City, Missouri; and at RMA Headquarters in Washington, D.C. Additionally, we interviewed the Texas State chemist, who regulates livestock feed and fertilizer in Texas; representatives of six AIPs; officials at eight grain elevators; an OGC official in Washington, D.C.; and other third parties as deemed necessary to accomplish the audit objective.

We also identified Federal and State regulatory action levels for Aflatoxin contamination as established by the FDA and the State of Texas. We reviewed RMA's policies and procedures for CYs 2005 through 2007 to evaluate the adequacy of management controls over the quality adjustments to production quantities. Specifically, we reviewed these policies to determine whether the deficiencies in the CY 2005 loss adjustment policies and procedures would be corrected through changes to policies and procedures made for CY 2007.

The SRCO staff provided us with a database of indemnities paid on claims filed by Texas corn producers in CY 2005. SRCO compiled the database by reviewing each of the claim files for 2,453 indemnity payments to Texas corn producers for CY 2005. SRCO's database of indemnified claims included data elements such as the level of Aflatoxin contamination and market values, which we used in our review. Using SRCO's database, we judgmentally sampled 397 claims for our review based on high Aflatoxin contamination and/or low market values. During our review we obtained and verified the final disposition records for each producer at the grain elevator where the producer's infected corn was delivered. The 397 sampled claims, representing the claims filed by 25 individual producers, were paid indemnities of \$3.3 million. From the 397 claims, we randomly selected 20 claims from different producers totaling \$406,636 and recalculated the indemnity for comparative purposes, using the policy and procedures

applicable for CYs 2005 and 2007. We compared those results against our calculations of the indemnity payments that would result from using OIG's proposed change. This was done in order to demonstrate the need for RMA to initiate a procedural change that would indemnify producers on a basis that is commensurate with the producer's economic loss. These comparative computations are presented in exhibit D.

In addition to the database compiled by the SRCO staff, we also used RMA's claims database maintained by the Kansas City Product Management Office. This database did not include data elements such as the level of Aflatoxin contamination existing in the corn crop for each claim and the market values used as an element in calculating the indemnity payment. We used this database to gather nationwide claims data and to validate the database provided by SRCO.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Exhibit A – Summary of Monetary Results

Finding Number	Recommendation Number	Description	Amount	Category
1	1	AIPs Failed to Verify the Usual, Customary, and Reasonable Market Values for Aflatoxin-Infected Corn in Settling Indemnity Payments	\$15,951,016	Questioned Costs – Recovery Recommended
Total:			\$15,951,016	

Exhibit B – Examples for Comparison of Prices Used by AIPs in Computing Aflatoxin Indemnities Versus Prices Obtained by Claimants Upon Sale of the Crop

Exhibit B – Page 1 of 2

Claimant	Unit Number	Estimated Market Value (Bid)	Final Sales Price	CY 2005 Indemnity	Final Sales Proceeds
A	102	\$0.08	\$1.10	\$ 11,670	\$ 7,782
A	104	\$0.08	\$1.10	\$ 98,447	\$ 24,276
A	106	\$0.08	\$1.10	\$ 25,280	\$ 10,930
B	103	\$0.08	\$2.07	\$127,619	\$105,707
B	107	\$0.08	\$2.07	\$ 25,206	\$ 19,484
B	134	\$0.08	\$2.07	\$ 29,492	\$ 21,875
B	164	\$0.08	\$2.07	\$ 20,370	\$ 14,623
C	105	\$0.08	\$2.05	\$ 4,356	\$ 7,537
C	110	\$0.08	\$2.05	\$ 17,501	\$ 8,960
C	150	\$0.08	\$2.05	\$ 48,195	\$ 26,071
D	101	\$0.08	\$2.00	\$ 51,889	\$ 37,394
D	102	\$0.08	\$2.00	\$ 6,358	\$ 4,724
D	106	\$0.08	\$2.00	\$ 24,360	\$ 27,973
E	108	\$0.08	\$1.90	\$ 6,105	\$ 4,028
F	5.00	\$0.25	\$2.07	\$ 2,443	\$ 3,994
F	7.04	\$0.25	\$1.91	\$ 3,841	\$ 1,839
F	7.06	\$0.25	\$1.87	\$ 3,884	\$ 7,052
G	4.02	\$0.25	\$1.85	\$ 4,211	\$ 8,224
G	6.00	\$0.25	\$1.75	\$ 3,882	\$ 4,125
H	1.00	\$0.25	\$1.85	\$ 3,931	\$ 11,095
H	8.01	\$0.25	\$2.00	\$ 12,132	\$ 32,044
I	300	\$0.08	\$1.00	\$ 12,123	\$ 7,661
I	600	\$0.08	\$1.00	\$ 7,322	\$ 4,820
J	106	\$0.08	\$1.60	\$ 13,669	\$ 9,087
J	108	\$0.08	\$1.60	\$ 14,970	\$ 8,291
J	109	\$0.08	\$1.60	\$ 11,674	\$ 9,539
K	8.02	\$0.25	\$1.24	\$ 38,951	\$ 61,071
K	9.00	\$0.25	\$1.25	\$ 12,253	\$ 11,897
K	10.00	\$0.25	\$1.31	\$ 13,467	\$ 11,350
L	105	\$0.08	\$1.20, \$ 1.60	\$ 41,211	\$ 37,790
L	303	\$0.08	\$1.20	\$ 16,713	\$ 13,275

Exhibit C - Excess Proceeds Realized Due to the Receipt of an Indemnity Payment for Aflatoxin-Infected Corn

Exhibit C- Page 1 of 2

Claimant	Unit Number	CY 2005 ²⁷ Indemnity	Aflatoxin ²⁸ Indemnity	Sales ²⁹ Proceeds	Indemnity ³⁰ and Sales Proceeds	Market ³¹ Value of Noninfected Corn	Excess ³² Proceeds
B	103	\$127,619	\$106,059	\$105,707	\$211,766	\$121,538	\$90,228
A	106	25,280	20,657	10,930	31,587	23,946	7,641
N	105	88,294	64,565	30,349	94,914	73,141	21,773
M	1010	4,268	4,268	15,543	19,811	9,814	9,997
L	303	16,713	16,713	13,275	29,988	26,435	3,553
E	109	29,250	29,250	31,419	60,669	39,853	20,816
J	109	11,674	11,674	\$9,539	21,213	13,951	7,262
O	3.01	2,815	1,370	20,344	21,714	13,697	8,017
P	114	6,343	4,217	1,624	5,841	4,751	1,090
K	9	12,253	12,253	11,897	24,150	14,264	9,886
Q	101	13,759	12,270	11,816	24,086	14,061	10,025
F	7.07	4,313	4,313	8,064	12,377	9,500	2,877
Totals		\$342,581	\$287,609	\$270,507	\$558,116	\$364,951	\$193,165

²⁷ This amount includes losses related to both production and value adjustment due to Aflatoxin.

²⁸ This column does not contain the portion of the indemnity amount related to the production losses.

²⁹ This amount is the actual proceeds the producers received from selling their Aflatoxin-infected corn crop.

³⁰ This amount is the CY 2005 indemnity plus the sales proceeds.

³¹ This amount was determined by multiplying the market price (taken from discount calculation) by the producer's production. This calculation does not include the loss due to production which causes it to be less than the CY 2005 indemnity.

³² Excess proceeds equal the indemnity and sales proceeds less the market value of noninfected corn.

Exhibit D — Comparison of Indemnity Payable Based on CYs 2005 and 2007 LAM Versus Actual Sales Price and Proposed CY 2009 Program Changes

Exhibit D– Page 1 of 1

Claimant	Unit Number	PPB Level	Indemnity Paid Based On CY 2005 LAM	Indemnity Payable Based on CY 2007 LAM	Indemnity Payable Based on Actual Sales Price of Corn	Proposed 2009 Program Changes
B	103	160	\$127,619	\$ 76,456	\$ 35,833	\$ 54,497
A	106	94	25,280	15,304	16,244	8,895
N	105	270	88,294	57,113	62,788	50,436
M	1010	210	4,268	488	0*	4,883
L	303	240	16,713	5,394	5,079	2,966
E	109	82	29,250	12,647	2,408	1,981
J	109	430	11,674	5,701	3,343	5,701
O	3.01	350	2,815	8,453 ³³	1,571	8,453
P	114	620	6,343	4,308	4,998	4,308
K	9	330	12,253	6,775	5,677	6,775
Q	101	220	13,759	7,840	3,547	6,570
F	7.07	110	4,313	699	0*	0*
G	6.00	290	3,882	1,910	501	1,403
C	105	130	4,371	688	0*	0*
D	102	490	6,358	3,985	2,254	3,985
H	1.00	56	3,932	526	0*	0*
I	6.00	110	7,322	4,019	4,620	2,604
R	1700	350	9,285	5,820	6,995	5,820
S	125	38	9,468	4,418	0*	93
T	107	310	19,437	14,046	10,722	14,350
Totals			\$406,636	\$236,590	\$166,580	\$183,720

* This amount was zero because the production adjustment using the sales price, and/or the proposed graduated scale was greater than the producer's guarantee. Therefore, no loss occurred.

³³ The indemnity payment on this claim was higher in CY 2007 because a higher market value was used in CY 2005 which caused the discount factor to be lower. Due to this the discount factor percentage in CY 2005 was then lower than the set discount factor of 50 percent used in CY 2007. This resulted in a larger indemnity payment in CY 2007 than the producer received in CY 2005.

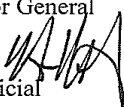


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TO: Robert W. Young
Assistant Inspector General for Audit
Office of Inspector General
SEP - 3 2008

FROM: Michael Hand 
Audit Liaison Official

SUBJECT: Office of Inspector General Audit 05601-15-Te, Official Draft Report,
Crop Loss and Quality Adjustments for Aflatoxin-Infected Corn

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

RECOMMENDATION NO. 1:

Issue administrative findings to recover the improper payments resulting from the approximately \$15,951,016 in CY 2005 Aflatoxin-infected corn claims for Texas that were calculated using market values of \$.25 or less per bushel.

RMA Response:

RMA remains extremely disappointed that this recommendation was not significantly revised or withdrawn based on the information disclosed to OIG at the exit conference, and requests reconsideration of this matter. The primary issue remains that OIG knew or should have known from conducting the audit that RMA issuing administrative findings to deny reinsurance for any indemnity based on under-market pricing was never in question, as RMA shared with OIG the evidence as well as the intent to issue administrative findings. In light of the fact that OIG (Investigations and Audit) failed to provide any meaningful assistance in this matter after RMA requested their involvement, makes this particular recommendation especially objectionable and places an additional and unnecessary administrative reporting burden on RMA.

Accordingly, RMA does not agree with the recommendation as it gives the appearance that the idea of denying reinsurance for these indemnities is an original OIG proposal. Additionally, it is RMA's position that under the most fundamental audit concepts, it is inappropriate to claim credit for monetary discrepancies already identified by the Agency. RMA is in the process of issuing findings as we conduct our routine analysis and evaluation of each disputed claim. Within the next year, the RMA, Southern Regional Compliance Office (SRCO) will continue to open cases and review all related claims to determine whether the associated indemnities should be reinsured. RMA also notes, again for the record, that we held up working on these determinations to ensure that our administrative actions would not complicate the identification and prosecution of potential criminal activity that was never fully reviewed as RMA requested.



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If the SRCO determines there is a monetary discrepancy due to invalid company determinations, RMA will establish an accounts receivable and collect any monies owed from the responsible AIP in accordance with yearly audited standard operating procedures. If the recommendation is not withdrawn, this process will expand to include the additional administrative requirement placed on RMA to report status and final disposition of each finding, first to OIG and then to the Office of the Chief Financial Officer as required by Departmental Regulations.

RMA requests OIG revise the management decision for this recommendation as indicated.

RECOMMENDATION NO. 2:

Revise the current claims adjustment LAM procedures to require that AIPs use the proposed graduated discount factors to compute a preliminary settlement toward the total indemnity payments for losses due to Aflatoxin contamination and adjust the payment based on the final sales price or market values determined for the crop upon final disposition.

RMA Response:

We partially agree with this recommendation. For the 2009 crop year, RMA has implemented graduated discount factors for certain types of mycotoxins for the crops of wheat, barley, canola, oats, rye, and flax and will also include corn, soybeans, grain sorghum, safflower, and sunflowers at the appropriate time for filing actual documents. Pre-established discount factor charts were added for aflatoxin, vomitoxin, and fumonisin. However, payment based on the final sales price or market values determined for the crop upon final disposition was not added. RMA believes that adding this consideration would result in other negative consequences for producers and insurance companies as follows:

- (1) Valuing production based on a market value as suggested by OIG when a producer elects to feed or use as silage or upon final disposition, other than being sold, would be difficult and may require the use of “bids” which resulted in allegations of fraud, waste, and abuse issues prior to the 2007 crop year.
- (2) By requiring producers to sell their aflatoxin infected production in order to receive a quality adjustment, RMA may actually cause more infected grain to enter the food chain than would have otherwise occurred by encouraging those producers who would not normally sell their grain, such as livestock feeders, to do so. Under RMA’s new graduated discounts that will be in place for the 2009 crop year, producers can utilize their infected production in manners other than selling it into the food chain and still receive the quality adjustment benefit.

RMA writes policies and procedures to direct how crop insurance will respond given the decisions or actions an insured producer has taken; however, crop insurance policies are written in a manner to not dictate how a producer must respond.

- (3) May result in earlier than normal sales of grain. The OIG recommendation could result in program vulnerabilities and RMA may be viewed as influencing the market place by requiring all aflatoxin production to be sold. Grain elevators could alter their prices for aflatoxin grain by lowering prices earlier in the harvest season from what perhaps they would have offered, knowing that the difference to the producer will be made up by increased crop insurance indemnities, thus shifting the risk to crop insurance. This could result in collusion between the grain elevators and the insureds or at least put the grain buyers in a position to impact the amount of indemnities and lessen what they have to pay to producers creating a vulnerability to the crop insurance program. The disposition of aflatoxin infected grain should occur in the same manner as if the production was not insured.
- (4) Claims may be held open for an extended length of time. Holding claims open for an extended length of time would create administrative burdens and inefficiencies for approved insurance providers. Every claim for which a preliminary payment is made will likely require a corrected claim at the time of final settlement to make adjustments for the normal changes in the market, and for reasons potentially not related to quality of grain. Generally, the corn market is higher several months after harvest, but this could result in depressing prices for aflatoxin corn longer than normal. Grain elevators would have an incentive to keep prices depressed realizing that insureds would need to sell to finalize their claims. While corrected claims could result in some insureds having to refund part of the indemnity payment, the converse could be true if grain elevators purposely hold down prices lower than they otherwise would have thus reflecting insureds were underpaid requiring companies to pay additional indemnity payments than would otherwise have been due by simply basing claims on the pre-established discounts. This could be a burden for many producers, especially in difficult economic times. Additionally, in the event a claim was over-paid approved insurance providers may encounter difficulty in collecting the overpaid amounts resulting in 1) unrecoverable losses; 2) placing producers on the ineligible list; and 3) arbitration and litigation.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 3:

Notify all AIPs that the current LAM procedures require that claims with Aflatoxin levels exceeding levels set by the Federal or State Government, or any other regulatory body, cannot be finalized until the final disposition of the crop.

RMA Response:

We partially agree with this recommendation. Within the next year, RMA will issue an Informational Bulletin to all AIPs notifying them of the above revised quality adjustment statements applicable for the 2009 crop year, and to remind each AIP and their loss adjusters of the requirement to use RMA-approved procedures. As stated above and for the reasons presented, the bulletin will not include a statement that the claim cannot be finalized until the final disposition of the crop, except in the case of “zero value” production that must be destroyed before payment can be made.

RMA requests management decision for this recommendation.

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

Informational copies of this report have been distributed to:

Administrator, RMA	3
Government Accountability Office	1
Office of Management and Budget	1
Office of the Chief Financial Officer	1
Director, Planning and Accountability Division	