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Southeast Region

Audit Report

Risk Management Agency
2005 Emergency Hurricane Relief Efforts

Report No. 05099-28-At
March 2009

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

March 4, 2009

REPLY TO
ATTN OF: 05099-28-At

TO: William Murphy
Acting Administrator
Risk Management Agency

ATTN: Michael Hand
Deputy Administrator
Risk Compliance

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

SUBJECT: 2005 Emergency Hurricane Relief Efforts

This report presents the results of the subject audit. Your written response to the draft report, dated January 14, 2009, is included as exhibit C 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 any of the 18 recommendations. Documentation and actions needed to reach management decisions for the 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 2005 Emergency Hurricane Relief Efforts (Audit Report No. 05099-28-At)

Results in Brief

In 2005, three hurricanes—Katrina, Rita, then Wilma—struck Florida, resulting in more than $275 million in nursery claims[1] from policies reinsured under the Risk Management Agency's (RMA) Nursery Crop Insurance Program, which is part of the Federal Crop Insurance Program. RMA administers the Federal Crop Insurance Program through cooperative financial assistance agreements, known as the standard reinsurance agreement (SRA), with private insurance companies, or approved insurance providers (AIP). Under this contractual obligation, an AIP assumes primary responsibility for underwriting policies and adjusting any losses that may occur.[2] Specifically, the AIPs' underwriting responsibilities include determining producers' eligibility, the risk involved to insure crops, and the amount of coverage. When losses occur, an AIP is required to verify the extent of damage and determine the appropriate losses under the insured's policy. The Office of Inspector General (OIG) initiated this audit to determine how well the AIPs responded to this disaster.

During our initial fieldwork, we selected five producers insured by one AIP, Rural Community Insurance Services (RCIS), and planned to select three producers insured by another AIP. RCIS was responsible for writing [ ] percent of the nursery liability in Florida in crop years (CY) 2005 and 2006.[3] It insured [ ] in liability and processed [ ] percent of the total indemnities, [ ], resulting from those liabilities.

After reviewing RCIS, we found pervasive errors in its underwriting and claims adjusting processes, described more fully below, that resulted in large overpayments to RCIS' insureds. Because of the extent of the errors we found at RCIS, we decided to limit our review to this one AIP. For the same reasons, we also concluded that RMA should seek an Office of the General Counsel opinion as to whether it may apply a provision of the SRA to RCIS which allows it to suspend the company from the Federal Crop Insurance Program.

At all phases of the insurance process—underwriting policies, adjusting claims for losses, and reporting its indemnities to RMA—RCIS did not fulfill its contractual obligations to which it had agreed to under the SRA.[4]

[1] Total based upon RMA indemnity payment data.
[2] The SRA defines underwriting as the determination of the terms and conditions by which the AIP will accept the risk for an eligible crop insurance contract.
[3] Since CY 2005 ended September 30, 2005, the three 2005 hurricanes spanned both CYs 2005 and 2006.
[4] 2005 SRA, §II.A.9(a)(i), dated June 10, 2004: AIPs agree to demonstrate substantial conformity with the requirements of this agreement and the regulations and FCIC procedures which include applicable handbooks, manuals, bulletins, memorandums, or other directives issued by FCIC.

- RCIS did not effectively underwrite [ ] in nursery liability. By failing to verify underwriting information submitted by agents, RCIS allowed its agents to determine the insured producers' eligibility and coverage—a clear conflict of interest. One agent in particular significantly deviated from required RMA-established nursery crop insurance policies and procedures. This agent wrote [ ] of the [ ] in nursery liability that his agency wrote—the largest volume of nursery business in Florida. RCIS then had RMA ultimately reinsure these improperly issued policies.

- RCIS did not comply with RMA's loss adjustment policies and procedures on claims it processed and paid. On all 19 claims we reviewed,[5] we found a systematic pattern of errors and noncompliance with RMA's nursery program loss adjustment policies and procedures by both RCIS' loss adjusters and its quality control reviewers. We found a total of 19 different categories of errors that RCIS' adjusters made and its quality control reviewers failed to detect. RCIS also adjusted loss claims using loss procedures that were not authorized by RMA.

- RCIS reported inaccurate claim information to RMA for reimbursement of the indemnities it paid producers. To do this, RCIS bypassed one of RMA's data acceptance system edit checks, thereby resulting in RMA reimbursing RCIS for uninsured crop losses.

The total errors identified during this review resulted in erroneous payments of $16,601,134 (see exhibit A).

Like all AIPs, RCIS entered into a contractual obligation with RMA when it signed the 2005 SRA. By signing the SRA, AIPs agree to *responsibly* administer the policies they insure; in exchange, RMA pays AIPs' administrative and operating costs for the policies they handle, allows the AIPs to retain a portion of the insurance premiums, and agrees to reinsure any losses that may occur. For AIPs, this is a financial relationship. For example, for administering just the nursery crop policies it issued in Florida for CYs 2005 and 2006, RCIS received [ ] in Federal funds. RCIS also retained underwriting gains totaling [ ] for all crops nationwide during these crop years.[6]

Since RCIS did not properly fulfill its contractual obligations under the SRA, the AIP seriously jeopardized the program integrity of the nursery crop program, and thereby breached its fiduciary responsibilities to RMA. The

[5] The 19 claims from the 5 RCIS-insured nursery producers were paid a total of $66.3 million (or [ ] percent of the [ ] in indemnities paid by RCIS).

[6] In the 2005 SRA, §I, "Definitions," dated June 10, 2004; RMA defines an "underwriting gain" as the amount by which an AIP's share of retained net book premium exceeds its retained ultimate net losses.

SRA provides that RMA may suspend an AIP for cause due to a material breach or failure to perform or comply with obligations.[7] While suspended, the AIP may not sell or authorize to be sold any new crop insurance contracts or renew or authorize the renewal of existing eligible crop insurance contracts.[8] RMA may also place representatives at any of the AIP's locations to monitor activities that directly or indirectly affect the performance of its obligations under the SRA.[9]

In conclusion, we recommend that RMA deny reinsurance for [ ] in liability for CYs 2005 and 2006. This liability has resulted in [ ] in indemnity payments. We also recommend that RMA recover the Government's share of these indemnity payments, [ ] in premium subsidies and [ ] in administrative and operating expenses. RMA should also recalculate the effect on the underwriting gains for both crop years and assess additional penalties to the maximum extent allowed under the SRA.

Our audit was conducted in conjunction with the President's Council on Integrity and Efficiency as part of its examination of the Federal Government's relief efforts in the aftermath of Hurricanes Katrina and Rita. As such, a copy of the report has been forwarded to the President's Council on Integrity and Efficiency, Homeland Security Working Group, which is coordinating the Inspectors General reviews of this important subject.

Recommendations In Brief

Seek an opinion from the Office of the General Counsel as to whether RMA can suspend RCIS from writing any new business or renewing any existing business in the Federal Crop Insurance Program until the conditions in this report are corrected.

Deny reinsurance for [ ] in liability underwritten by RCIS for CYs 2005 and 2006 Florida nursery policies.

Recover the Government's share of the [ ] in indemnities that RCIS paid out on these policies, [ ] in premium subsidies, and [ ] in administrative and operating expenses.

Recalculate the effect on the underwriting gains for both crop years. Also, assess additional penalties to the maximum extent allowed under the SRA.

Direct RCIS to retain pre-acceptance inspection reports for all nursery producers actively insured in each crop year.

[7] 2005 SRA, §IV.I, "Suspension," dated June 10, 2004.
[8] 2005 SRA, §IV.I, "Suspension," para. 2, dated June 10, 2004.
[9] 2005 SRA, §IV.O, "Oversight and Cut-Through," 1(b), dated June 10, 2004.

Initiate a review to determine if the agent's actions were willful and, if they were, debar this agent from participating in the Federal Crop Insurance Program.

Validate that RCIS has implemented an underwriting process that meets the requirements of the Federal Crop Insurance Program.

Adjust RCIS' accounting records by overpayments totaling $16,134,913 and underpayments totaling $466,221 identified in our review.[10]

Recover from RCIS any overpayments on the claims for which the AIP misreported indemnity data.

Agency Response

In the January 14, 2009, written response to the draft report, RMA generally agreed with 15 recommendations for recovery of overpayment and strengthening of AIP's program management; however, it did not agree with 3 recommendations to deny reinsurance for [ ] in liability, to recover the Government's share of the [ ] in indemnities, [ ] in premium subsidies, [ ] in administrative and operating expenses, and to recalculate the effect on the underwriting gains. RMA cited an Office of the General Counsel (OGC) opinion as the basis of its disagreement. According to RMA, the OGC opinion states[

]. RMA's response to the draft report is included as exhibit C of the audit report.

OIG Position

We cannot fully concur with the proposed corrective actions for any of the 18 recommendations. We are also concerned about the timeframes proposed for completing corrective actions. We believe the audit results presented in this report demonstrate a systemic pattern of the AIP's failure to follow RMA's policies and procedures while underwriting nursery crop insurance policies, adjusting resulting losses, and reporting loss data to RMA. In addition, throughout the course of our audit, we have worked closely with both RMA and OGC officials and obtained their input and guidance in formulating exceptions to policy issues and related recommendations to correct noted deficiencies. We have also provided RMA investigators documentation of audit evidence to assist in their independent review of RCIS.

[10] If RMA makes a determination to deny reinsurance and, therefore, any indemnity payments relating to the reinsurance for all of RCIS' nursery policies (or only for policies involving the 19 reviewed claims), RMA does not need to pursue recovery of the specific questioned amounts identified as ineligible or identified as loss adjustment errors.

We have incorporated applicable portions of RMA's written responses into the draft report along with our position in the Findings and Recommendations section of this report.

Abbreviations Used in This Report

AIP	Approved Insurance Provider
CY	Crop Year
DAS	Data Acceptance System
LAM	*Loss Adjustment Manual Standards Handbook*
LASH	*Loss Adjustment Standards Handbook*
OGC	Office of the General Counsel
OIG	Office of Inspector General
PIVR	Plant Inventory Value Report
RCIS	Rural Community Insurance Services
RMA	Risk Management Agency
SOP	Standard Operating Procedure
SRA	Standard Reinsurance Agreement
USDA	Department of Agriculture

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Background and Objective

Background

The Federal Agriculture Improvement and Reform Act of 1996 authorizes the Risk Management Agency (RMA) to administer the Federal Crop Insurance Program through cooperative financial assistance agreements, known as the Standard Reinsurance Agreement (SRA), with private insurance companies, or approved insurance providers (AIP). Under this contractual obligation, AIPs are responsible for selling and servicing crop insurance policies. So long as AIPs *responsibly* administer these policies, RMA reinsures the policies and reimburses a portion of any indemnities paid to producers. RMA also pays AIPs an administrative fee for their work.

The AIPs' contractual obligation requires that companies must underwrite policies and adjust any losses that may occur. Underwriting is one of the primary functions of any insurance company. It includes the process of determining applicants' eligibility, the risk involved to insure crops, the amount of coverage and premiums, and the terms of the insurance policy.[11] When AIPs agree to participate in Federal Crop Insurance Programs, RMA assumes responsibility for two underwriting functions—it writes the terms of the insurance policy and sets premium rates.[12] The SRA provides that AIPs will determine applicants' eligibility, the risk involved to insure crops, and the amount of coverage.[13] According to the contractual obligations of the SRA, AIPs must follow RMA's crop-specific underwriting policies and procedures.[14]

When losses occur, the contractual obligations of the SRA require that AIPs send adjusters into the field to determine the extent of damage and the appropriate losses under the insured's policy.[15] RMA has established general procedures for this process, known as the *Loss Adjustment Manual* (LAM) *Standards Handbook*. In addition, since RMA reinsures producers on a crop-by-crop basis, the agency publishes loss adjustment standards for each crop; these standards are known as the *Loss Adjustment Standards Handbook* (LASH). According to the contractual obligation of the SRA, AIPs must follow both the LAM and the appropriate LASH when adjusting losses and computing indemnity payments.

[11] *2005 Nursery Crop Insurance Underwriting Guide*, Table of Contents, dated June 1, 2004.
[12] 05-BR Common Crop Insurance Policy, preamble, "Terms and Conditions Basic Provisions," 7 Annual premium (d); 99-073 Nursery Crop Provisions revised October 1998 and 06-073 Nursery Crop Provisions revised June 2005.
[13] 2005 SRA, §IV.F, "Insurance Operations," 1(a) through (c), dated June 10, 2004, and RMA's *Nursery Crop Insurance Underwriting Guides* (indexes) dated June 1, 2004, and August 19, 2005.
[14] 2005 SRA, §IV.F, "Insurance Operations," 1(a) through (c)., dated June 10, 2004.
[15] 2005 SRA, §IV.F, "Insurance Operations," 1(a), dated June 10, 2004, and 2005 LAM, part. 1(8)(A) through (B), dated July 12, 2005.

The Nursery Crop Insurance Program

In 1989, the Federal Government established the Nursery Crop Insurance Program to insure wholesale nursery producers against damage due to catastrophic weather events. The program defines nursery producers as businesses operating a wholesale nursery that produces and sells nursery plants. Only wholesale enterprises may apply for nursery crop insurance.[16]

In 1995, RMA reinsured policies nationwide with $240 million in liability through the Nursery Crop Insurance Program. This liability had grown to $3.9 billion in 2005 and $3.7 billion in 2006. In total, nursery producers were paid indemnity payments of $135.8 million in 2005 and $147.3 million in 2006.

Unlike ordinary row crops—which consist of acres of identical plants—insurance for nursery crops is complicated since RMA insures thousands of different plant species of differing sizes. Not only is the program complex, but an acre of nursery plants is generally more valuable than an acre of row crops. For example, in Florida, an acre of orchids was valued at $769,000, an acre of tomatoes at $6,030, and an acre of corn at $178.[17]

Due to the complexity of the Nursery Crop Insurance Program, nursery producers must keep more detailed farming records than producers insured under row-crop programs. Each individual plant type they produce has a value that is determined by its species, size, and quantity. When producers apply for insurance, they are required to report the value of all plants in their nursery supported by farming records. They must also maintain ongoing farming records of plant pottings, purchases, sales, and the transfer of plants between nurseries.

In parts of the country, producers purchase nursery crop insurance primarily to protect themselves against damage resulting from hurricanes. Not only do many nursery producers operate in Florida, but Florida is also particularly susceptible to hurricanes. Of the total nationwide nursery crop insurance issued in 2005, Florida nursery producers account for 28 percent of $3.9 billion in liability; in 2006, Florida nursery producers account for 27 percent of $3.7 billion in liability. For crop years (CY) 2005 and 2006, indemnity payments in Florida accounted for 97 percent of the total indemnities paid on all nursery crops.

[16] *2005 Nursery Crop Insurance Underwriting Guide*, §3, dated June 1, 2004, provides a nursery that receives more than 50 percent of its gross income from retail plant sales is not eligible for coverage under the nursery crop insurance provisions.
[17] These prices were current in 2005.

2005 Florida Hurricanes

In 2005, three major hurricanes struck Florida within the span of 2 months. Hurricane Katrina made landfall on August 25, Hurricane Rita on September 21, and Hurricane Wilma on October 24.[18] The President declared 29 Florida counties Federal disaster areas and directed the Department of Agriculture (USDA) to assist growers affected by the hurricanes.

Nursery producers were severely affected by the 2005 hurricanes. RMA has estimated that, in Florida, these 3 hurricanes resulted in about 2,500 nursery claims and $275 million in indemnity payments. This total was 47 percent of total indemnities paid to Florida producers for all crops.

RMA responded to this emergency by streamlining how AIPs paid claims.[19] For nursery claims, the agency waived the policy requiring plant destruction certification forms before making payments if the loss adjuster certified that the plants were not salvageable. This change to the nursery crop program was nominal and did not significantly alter the loss adjustment process. RMA also clarified that all nursery loss determinations occurring after September 30, 2005, would follow the new nursery LASH for 2006, and did not exempt or waive any RMA requirements.

Objective

Our objective was to evaluate the adequacy of RMA's management controls to ensure the propriety and accuracy of indemnity payments resulting from Hurricanes Katrina, Rita, and Wilma in Florida. However, due to the magnitude of the problems we found with RCIS' loss adjustment determinations for crops affected by these hurricanes, we focused on RCIS' management controls for underwriting nursery crop insurance policies and adjusting claims.

This report focuses on the deficiencies in RCIS' administration of the Nursery Crop Insurance Program in Florida and its impact on RMA's reinsurance of RCIS' policies. Also we evaluated whether RCIS met its contractual obligations under the SRA to underwrite nursery crop policies and adjust losses in accordance with RMA policy.

[18] Because RMA's 2005 nursery crop year ended on September 30, 2005, damage from Hurricane Wilma occurred during CY 2006.
[19] RMA issued Manager's Bulletin, MGR-05-017, dated September 15, 2005, and Manager's Bulletin, MGR-05-020, dated November 4, 2005.

Findings and Recommendations

Section 1. RCIS Breached the Standard Reinsurance Agreement

Finding 1 RCIS Breached the Terms of the Standard Reinsurance Agreement

By signing the SRA, RCIS agreed to *responsibly* underwrite the policies it insured, accurately adjust claims for losses, and reliably report indemnity data to RMA. In return, RMA agreed to reinsure these policies, pay a portion of policy premiums and any claims for losses, and reimburse RCIS for its administrative and operating costs. However, we found that RCIS failed to perform its contractual obligations under the SRA, and that RCIS and its agents materially deviated from RMA's policies and procedures. First, RCIS did not effectively carry out its underwriting responsibilities for the policies it insured and accepted information entered by its agents without the company's verification. Second, on all 19 claims[20] we reviewed, we found a systematic pattern of errors and major noncompliance with RMA's nursery program loss adjustment policies and procedures. Finally, RCIS bypassed one of RMA's data acceptance system (DAS) edit checks and misreported nursery indemnity information for uninsured crop losses to RMA. For CYs 2005 and 2006 nursery program, RCIS issued policies totaling [ ] in liability that did not meet the SRA's underwriting criteria and paid [ ] in indemnities for claims based on policies that should not have been reinsured. RCIS' actions materially breached the SRA, and jeopardized the integrity of the Federal Nursery Crop Insurance Program.

RCIS had three responsibilities under the SRA—to underwrite nursery policies according to RMA's policies and procedures, correctly adjust any claims for losses that resulted from these policies, and accurately report to RMA the indemnities it paid producers for their losses.[21] We found that RCIS did not fulfill these three responsibilities.

- RCIS did not effectively underwrite [ ] in nursery liabilities. When AIPs issue policies they are responsible for underwriting those policies, which include determining the applicant's eligibility, the risk involved to insuring crops, and the coverage provided.[22] We found that RCIS relied on the edits and checks in its automated data entry

[20] These 19 claims included 17 nursery claims and 2 rehabilitation claims.
[21] The 2005 SRA, §IV.F.1(b), dated June 10, 2004, states that AIPs must use contracts, standards, procedures, methods, and instructions as authorized by RMA in the sale and service of eligible crop insurance contracts. In the 2005 SRA, §I, dated June 10, 2004, RMA defines "underwriting" as the determination of the terms and conditions by which the company will accept the risk for an eligible crop insurance contract. The 2005 SRA, §IV.F.1(a), dated June 10, 2004, states that AIPs must verify yields and other information used to establish insurance guarantees and indemnity payments in accordance with the regulations and procedures.
[22] See Finding 2; *2006 Nursery Crop Insurance Underwriting Guide*, §13(A) through (D), dated August 19, 2005.

system [ ], and was not effectively verifying information that agents entered into this system. Thus, RCIS accepted producers' applications for insurance; even though producers did not have records to support their plant inventory value report (PIVR)—the essential insurance document for the nursery program.[23]

By failing to underwrite nursery policies effectively, RCIS allowed its agents at over 3,200 local agencies nationwide to approve policies and to maintain the company's official underwriting files and documents. Since RCIS performed minimal verification of the underwriting information agents entered into [ ], these agents essentially acted as underwriters of the policies they sold. This is a clear conflict of interest because agents' commissions are based on the total premiums for the insurance policies they sell. We concluded that agents should not be placed in the role of approving and reviewing policies that directly affect the commissions they will receive and how much liability an AIP and the Government should assume. For 17 of the 19 claims we reviewed, a single agent sold *and* underwrote these producers' policies. This agent significantly deviated from RMA policies and procedures, including encouraging producers to estimate their inventories on their PIVRs and selling invalid peak endorsements which led to $6.6 million in overpayments.[24, 25]

- RCIS did not comply with RMA's loss adjustment policies and procedures on claims it processed and paid. When a producer files a claim for a loss, the loss adjuster is required to visit the field to independently determine plant inventory, verify the loss, and calculate the indemnity.[26] We found, however, that RCIS loss adjusters made many serious errors at all phases of the loss adjustment process, ranging from accepting producers' estimates of damage without independent verification to allowing claims for uninsured plants. Of the $66.3 million in claims we reviewed, we found that loss adjusters issued $10,644,328 in overpayments and $466,221 in underpayments.

  RCIS' business practices contributed to the loss adjustment errors we identified. RCIS' quality control review process did not detect these adjustment errors.[27] And officials at RCIS Headquarters developed and disseminated to the AIP's adjusters an unauthorized loss adjustment procedure that contradicted RMA's published policy that a damaged plant be held at the reduced value until fully recovered. (Instead, adjusters were instructed to use 2006 prices, that is, the full

[23] See Finding 2.
[24] In CY 2005, RMA allowed producers to purchase two peak inventory endorsements to insure the value of insurable plants over those reported on the PIVR. One agent sold more than the two allowable peak endorsements.
[25] See Finding 3.
[26] 2005 LAM, part 1, §8.B(5) and (7)(d), dated July 12, 2005; 2006 LAM, part 1, §8.B(5) and (7)(d), dated February 1, 2006.
[27] See Finding 5.

value, rather than the after-loss 2005 value for plants damaged by earlier hurricanes.) This error alone led to at least $979,946 in erroneous payments.[28]

- RCIS reported inaccurate claim information to RMA for reimbursement for the indemnities it paid producers. The company's loss adjusters had incorrectly calculated indemnities for plant types that producers had neither insured nor paid premiums on. When RMA's DAS detected that producers' premium records did not match their loss records, it rejected 109 claims. Believing this was merely a data entry problem, RCIS employees then included uninsured plant types under insurable plant types to bypass one of DAS' edit checks which was intended to ensure that RMA would limit the claim only to insured plant types. We reviewed 14 claims that RMA had rejected, and found that indemnities had been improperly paid for uninsured plants on 10 claims resulting in overpayments totaling $990,541, reported in Finding 7, and another 2 claims resulting in $80,976 overpayments, reported in Finding 4.

Under the terms of the SRA, RMA may suspend RCIS for cause due to a material breach or failure to perform or comply with obligations. While suspended, RCIS may not sell or authorize to be sold any new crop insurance contracts or renew or authorize the renewal of existing eligible crop insurance contracts.[29] RMA may also place representatives at any RCIS location to monitor activities that directly or indirectly affect the performance of RCIS' obligations under the SRA.[30]

The Office of Inspector General (OIG) believes that such a systematic pattern of errors and significant noncompliance with RMA's policies and procedures constitute material breaches of the SRA. Therefore, we have concluded that RMA has reasonable cause to suspend RCIS from participation in the Federal Crop Insurance Program. OIG also maintains that RCIS did not responsibly underwrite [ ] in liabilities for CYs 2005 and 2006 Florida nursery policies. RMA should deny reinsurance for these policies, and recover the Government's share of [ ] in indemnities, [ ] in premium subsidies, and [ ] in administrative and operating expenses. RMA should also recalculate the effect on the underwriting gains for both crop years[31] and assess additional penalties to the maximum extent allowed under the SRA.

[28] See Finding 6 (errors are included in exhibit B).
[29] 2005 SRA, §IV.I, "Suspensions," para. 2, dated June 10, 2004.
[30] 2005 SRA, §IV.O, "Oversight and Cut-Through," para. 1(b), dated June 10, 2004.
[31] RMA calculates the effect of the indemnity payments by comparing the AIP's net losses against its retained net premium to determine whether there is an underwriting gain or loss, and then RMA adjusts accordingly the AIP's accounting.

Recommendation 1

Seek an opinion from the Office of the General Counsel (OGC) as to whether RMA can suspend RCIS from writing any new business or renewing any existing business in the Federal Crop Insurance Program until the conditions in this report are corrected.

Agency Response

RMA officials concurred with the recommendation. RMA obtained an opinion from OGC who opined that, [

]. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with the recommendation, we cannot reach management decision. To achieve management decision, RMA needs to provide OIG with (1) a copy of the OGC opinion referred to in its response to this recommendation; and (2) a copy of RMA's independent followup review and investigation of RCIS' operations (or RMA's justification for not conducting a followup review and investigation). The copy of its review and investigation should include RMA's final determination whether to suspend RCIS from writing any new business or renewing any existing business in the Federal Crop Insurance Program.

Recommendation 2

Deny reinsurance for [ ] in liability underwritten by RCIS for CYs 2005 and 2006 Florida nursery policies.

Agency Response

See Recommendation 4.

OIG Position

See Recommendation 4.

Recommendation 3

Recover the Government's share of the [ ] in indemnities that RCIS paid out on these policies, [ ] in premium subsidies, and [ ] in administrative and operating expenses.[32]

Agency Response

See Recommendation 4.

OIG Position

See Recommendation 4.

Recommendation 4

Recalculate the effect on the underwriting gains for both crop years. Also, assess additional penalties to the maximum extent allowed under the SRA.

Agency Response

RMA did not concur with Recommendations 2, 3, and 4. In the exit conference for this audit, an OIG senior staff member explained the report contained two monetary recommendations and an OGC opinion would determine what actions would be appropriate for RMA to implement. Because OGC has opined that [

]. For this reason, RMA has initiated actions to implement the other monetary recommendations contained within this report. RMA requests management decision for these recommendations.

OIG Position

We cannot reach management decision for Recommendations 2, 3, and 4. According to RMA, the OGC opinion cited in Recommendation 1 states that [

].

[32] If RMA makes a determination to deny reinsurance and, therefore, any indemnity payments relating to the reinsurance for all of RCIS' nursery policies (or only for policies involving the 19 reviewed claims), RMA does not need to pursue recovery of the specific questioned amounts identified as ineligible or identified as loss adjustment errors identified in the later findings and recommendations.

We believe the audit results presented in this report demonstrate a systemic pattern of the AIP's failure to follow RMA's policies and procedures while underwriting nursery crop insurance policies, adjusting resulting losses, and reporting loss data to RMA. The sample of claims we reviewed represented [ ] percent of the total indemnities paid by the AIP ($66.3 million of [ ] of indemnity payments). For each of the sampled loss claims we reviewed (or 100 percent of our sample), we found deficiencies resulting in improper indemnity payments totaling over $15 million. If additional evidence is needed for RMA to demonstrate a systemic pattern in order to implement these recommendations, then RMA needs to [ ].

Given the severity of the problems that OIG found, we need additional information from RMA to achieve management decision. RMA needs to provide us with: (1) a copy of the OGC opinion [ ]; (2) its determination whether additional followup review and investigation by RMA of the AIP's compliance with the SRA is warranted or not warranted; and (3) if a further review and investigation is warranted, the results of any corrective actions resulting from the followup review and investigation, including whether to suspend the AIP from writing any new business or renewing any existing business in the Federal Crop Insurance Program.

Recommendation 5

Designate an oversight representative to monitor RCIS' activities, including needed corrective actions discussed in this report, until it complies with the terms of the SRA.

Agency Response

RMA concurred with this recommendation. The RMA, Reinsurance Service Division (RSD) has an Account Executive (AE) assigned to each approved insurance provider (AIP), and established processes and procedures to address and correct SRA violations. In accordance with established RSD written processes and procedures, whenever an SRA violation is detected and the need for corrective action has been determined by RMA, a corrective action plan is developed by RSD and the AE oversees the implementation of corrective action until the AIP fully complies with the terms of the SRA. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with this recommendation, we need additional information before we can reach management decision. In the normal course

of business, RMA assigns an AE to each AIP to oversee the implementation of any corrective action plans. In Recommendation 5, we intended that RMA, under the authority given to it in the SRA, designate an oversight representative to closely monitor the AIP's activities until all corrective actions have been implemented; we believe that such monitoring is beyond the routine monitoring by the AE. To reach management decision, RMA needs to designate (or provide us a timeframe when it expects to designate) an oversight representative to monitor the AIP's activities until it complies with the terms of the SRA.

Instead of fulfilling its underwriting responsibilities, RCIS accepted underwriting information entered by its agents into a database without effectively verifying the accuracy of that information. Under the 2005 SRA, AIPs are responsible for performing three underwriting functions—determining producers' eligibility, the level of coverage, and the risk involved—yet we found that RCIS did not effectively perform two of these three tasks.[33] Since it did not independently determine eligibility or the coverage, we are uncertain how RCIS was able to assess the risk involved with these policies. RCIS (and ultimately RMA) assumed liability for nurseries even though producers could not support the values they insured on the PIVR—the essential document for insuring nurseries. Without this support, insurance should not have attached to the policies we reviewed, and RCIS should not have paid indemnities for those 19 claims totaling $66.3 million.

OIG and RMA have made RCIS aware of the problems identified during this audit, but company management has not taken responsibility for these problems and has not taken adequate corrective actions. As our audit proceeded, we learned that two of the producers we reviewed had—once again—submitted unsupported PIVRs for CY 2008. Total liability for these two producers amounted to $156.1 million. Recognizing the seriousness of this ongoing problem, on May 31, 2007, OIG issued a management alert describing how RCIS continued to issue new CY 2008 nursery policies without support for the inventory values producers are insuring.

RMA agreed with our recommendations and quickly responded by issuing a letter to RCIS on June 15, 2007, requiring that RCIS:

- Obtain from producers documentation to support values reported on the PIVRs for all CY 2008 policies written.

- Formally notify its agents that PIVRs are required to be supported by an actual plant inventory and producer records.

- Formally notify its agents to verify that the peak inventory value reports are properly and correctly reported and are supported by proper documentation.

- Require its agents to obtain a signed certification from each producer documenting that they (1) submitted a PIVR supported by a physical inventory, (2) received a detailed listing of the farming records that must be maintained, including an ongoing inventory, and (3) were

[33] 2005 SRA, §II.B, "Reinsurance," paras. (1) through (5), dated June 10, 2004.

informed by their agent about the nursery crop insurance policy record requirements and retention.

Rather than proactively addressing these problems, RCIS, in its June 21, 2007, response, criticized OIG's understanding of the program requirements, specifically the requirement that the PIVR must be supported by producer inventory records.[34] RCIS also stated that two of the recommendations were "unreasonable". RCIS objected to (1) requiring all the producers it wrote nursery policies for to provide the inventory records supporting their PIVRs as required in the policy, and (2) asking producers to sign certifications that they have been notified of and understand the insurance policies' recordkeeping requirements.

On February 28, 2008, the RMA Administrator issued *Manager Bulletin* MGR 08-003 to all AIPs. The bulletin informed AIPs that OIG had found instances that involved significant amounts of coverage where policyholders did not have inventory records to support their PIVR and their peak endorsements; that AIPs must ensure compliance with the terms of the Nursery Crop Insurance Provisions and Endorsements; and that premium, liability, and any indemnities are properly established and supportable. RMA also informed the AIPs that it will annually spot check compliance with this bulletin.

Finding 2 RCIS Did Not Effectively Underwrite Nursery Policies

AIPs are responsible for underwriting the policies they insure. These responsibilities include determining whether a producer is eligible for crop insurance and, if so, the amount of coverage to insure. We found, however, that RCIS did not effectively carry out these underwriting responsibilities for the policies it insured. This occurred because RCIS was relying on its automated system [ ], which did not involve independent verification of the data agents entered. Without such verification, RCIS allowed policies reinsured by the Federal Government to be underwritten by its agents, whose commissions are based on selling these policies and not on verifying whether producers are eligible or how much coverage they should receive. Since RCIS did not effectively underwrite the policies it issued during CYs 2005 and 2006 in Florida, we question whether the AIP should have insured policies totaling [ ] in liability. These policies resulted in claims totaling [ ], including the $66.3 million in claims we reviewed.

[34] 99-073 Nursery Crop Provisions, §6(c), revised October 1998.

When AIPs sign the SRA, they enter into a contractual obligation with RMA in which they agree to underwrite the policies they issue.[35] As one of the most basic functions of any insurance company, underwriting includes the process of determining the applicant's eligibility, the risk involved to insure the crops, the amount of coverage and premiums, and the terms of the insurance policy.[36] In the Federal Crop Insurance Program, underwriting functions are shared between RMA and the private companies—AIPs are responsible for determining the applicant's eligibility, the risk involved to insure the crops, and the amount of coverage. The *Nursery Crop Insurance Underwriting Handbook* also requires that AIPs perform an underwriting review to determine if the information used to establish coverage is complete and accurate.[37]

When OIG visited RCIS to speak with company executives concerning how the AIP underwrote policies, they stated that the AIP did not have an underwriting department, regarded RMA as the underwriter of these policies, and saw itself as verifiers of information rather than underwriters. After being given an opportunity to review an earlier draft of this report, RCIS revised these statements, claiming that there was a misunderstanding. At this later date, the company stated that it "has a complex and detailed underwriting process . . . . comprised of computer edits and checks as well as verification and interaction by RCIS personnel in all phases of policy handling." The officials we initially spoke with, including the National Claims Manager, the leader of the compliance department, the National Sales Manager, and the company's staff attorney however, did not mention this "complex and detailed underwriting" process to us at the time of our visit. Our request to meet with the company's President was denied because it was against standard company procedures.

In its subsequent written response from another attorney hired by RCIS' parent company, Wells Fargo, to respond to OIG concerns, the attorney described a data entry system called [ ] as software used "to quote, verify, and process eligible crop insurance contracts." According to Wells Fargo's attorney, "[ ] is coupled with review and substantiation of data by RCIS employees to provide a comprehensive underwriting and verification process." The Wells Fargo's attorney provided a lengthy description of the various edit checks within [ ], and argued that this system fulfilled RCIS' underwriting responsibilities.

This description of [ ] edit checks illustrates inconsistency in AIP officials' knowledge of its underwriting responsibilities and processes. As we have previously stated, one of the AIP's fundamental underwriting

[35] 2005 SRA, page (i), dated June 10, 2004.
[36] 2005 SRA, §II.B, "Reinsurance," paras. (1) through (5), dated June 10, 2004.
[37] *2005 Nursery Crop Insurance Underwriting Guide*, § 9.A and B(1)(b)(c) and (e), dated June 1, 2004; *2006 Nursery Crop Insurance Underwriting Guide*, §9.A and B(1)(b)(c) and (e), dated August 19, 2005.

responsibilities is to determine the amount of insurance a producer should receive; in the nursery program, the fundamental document for determining the amount of insurance is the PIVR. An AIP's responsibility is to verify that the information the producer and the agent have submitted is accurate, and that the AIP and the Federal Government are accepting reasonable, supportable risk for eligible crops.

RCIS relied on the edit checks in [ ] for verification of CYs 2005 and 2006 policy data. This data was entered by the agent—an individual with an interest in earning commission for sales—and included no independent verification of that data by the AIP. According to RCIS, [ ] contained many edit checks to ensure that the agent was entering intelligible data. However, we found that the agent's work was not verified by an independent AIP review.

OIG maintains that the picture being presented of [ ] in RCIS' revised description of its underwriting is misleading. It is, in RCIS' words, computer software used to quote, verify, and process eligible crop insurance contracts by agents in the sale and service of crop insurance. We found that [ ] will put a hold on, or suspend, an application if the agent neglects to enter the producer's State and county, for instance. But [ ] is not an effective system for independently verifying overall accuracy and support of the information, e.g. the PIVR value, the agent submits. The AIPs are responsible for determining the amount of insurance a producer should receive. However, due to RCIS' reliance on its [ ] computer software, RCIS did not effectively underwrite nursery policies.

Without independently verifying the information the agents submit, RCIS is in effect, allowing sales decisions made by its agents to substitute for underwriting decisions that RCIS should make. For agents to assume this role is a conflict of interest because agents earn commissions based on how much insurance they sell; not on whether the AIP and the Government should assume an appropriate level of risk.

In contrast, when we spoke to one agent about his role in underwriting the policies for 17 of the 19 claims we reviewed, he stated that underwriting was RCIS' responsibility and he did not underwrite policies at all. Yet the only determination of producers' eligibility and coverage—the essence of what underwriting should mean for an AIP—was being performed by the agents.

Both RMA and OIG maintain that there are problems with how RCIS accepted liability for these policies. A RMA senior official stated that the agency published an underwriting handbook for the AIPs to follow, but that it is the AIPs' responsibility to administer the policy. By not determining producers' eligibility and coverage, RCIS was not accomplishing its obligations under the SRA.

RCIS Did Not Effectively Determine Producers' Eligibility

For the 17 nursery claims[38] we reviewed, we identified two problems that should have been detected during RCIS' underwriting review of producers' eligibility, had there been such a review. RCIS insured a nursery that had no sales for the last 3 years and insured nurseries where pre-acceptance inspections had not been performed. This occurred because the company did not effectively underwrite policies according to the terms of the SRA. As a result, RCIS accepted and passed on to the Federal Government liability for policies issued that did not comply with the requirements of the SRA and later paid indemnities for claims resulting from the 2005 hurricanes.

Determining producers' eligibility and coverage and the risk involved are critical functions of underwriting that AIPs take responsibility for when they sign the SRA.[39]

RCIS Insured a Nursery That Had No Sales for the Last 3 Years

Based on RMA's definitions of insurability, 50 percent of an eligible nursery's income must be derived from wholesale transactions.[40] We found, however, that RCIS insured a nursery that had no recent sales. When nursery producers apply for insurance, they are required to submit price catalogs of plants available for wholesale. However, we found that RCIS accepted the same price list for two nurseries. When we questioned the validity of this price list, we learned that the second nursery was not, in fact, a wholesale nursery since it recorded no sales of its own for the 3 years of tax returns we reviewed.

We concluded that the nursery did not meet RMA's standard for insurability, should not have been insured, and received improper indemnities totaling $5,727,137.[41] If RCIS had carefully verified the information the agent submitted on behalf of this producer, it could have detected this error and prevented this ineligible nursery from being insured.

RCIS Did Not Always Perform Pre-acceptance Inspections of the Nurseries It Insured

To be eligible for insurance, the N*ursery Crop Insurance Underwriting Handbook* requires that AIPs perform pre-acceptance inspections.[42] Pre-acceptance inspections involve a physical field inspection of the nursery to determine its eligibility. Because nursery policies are often renewed

[38] Of the 19 claims reviewed, 17 were nursery claims and 2 were rehabilitation claims.
[39] 2005 SRA, §IV, "General Provisions," para. F(1) (a) and (b), dated June 10, 2004.
[40] *2005 Nursery Crop Insurance Underwriting Guide*, §3, dated June 1, 2004.
[41] This nursery received an indemnity of $5,461,294 for Hurricane Wilma and a rehabilitation endorsement payment of $265,843.
[42] *2005 Nursery Crop Insurance Underwriting Guide*, §9(A), dated June 1, 2004.

over several years, a pre-acceptance inspection may apply to a policy over several years. However, AIPs must maintain all policyholder records for a minimum of 3 years after final action on *a policy for the CY*[43] (OIG's emphasis). An AIP could discard records of pre-acceptance inspections, but only 3 or more years after the policy had expired. In other words, so long as a producer was insured in a given year—as all of the producers we reviewed were in CYs 2005 and 2006—we believe that a pre-acceptance inspection should have been on file to document the producer's insurability.

Based on our review of the records, we found that RCIS did not maintain reports of pre-acceptance inspections. Of the 89 pre-acceptance inspections that we believe should have been on file for the producers' growing locations in our sample, we were able to determine that only 20 inspection reports had been retained. For the other 69 growing locations, RCIS could not provide evidence that inspections were completed and that the producers' nurseries were insurable. For 2 of the 20 inspection reports that we found, the reports indicated that the inspections had not been performed due to reasons such as a dog on the property or a locked gate. RCIS contended that it was required to maintain a copy of the pre-acceptance inspection for up to 3 years after the end of a crop year.

Pre-acceptance inspections permit the insurance company to determine not only the eligibility of the property it insures, but also the risk it will be assuming. Given the high value for an acre of nursery crops compared to row crops or the total liability of each policy, it is vital that pre-acceptance inspections be performed so that an AIP knows that the nursery it is insuring is being properly run and is an appropriate risk. Once these inspections are performed, we believe that prudent business practices would require that the pre-acceptance inspection reports be maintained during the term of the policy to adequately document the requirement that the nursery was insurable and eligible.

Since RCIS may have violated the terms of the Nursery Crop Insurance Program when it accepted liability for 69 of 89 properties without maintaining documentation of pre-acceptance inspections (and placed RMA at a significant risk), we concluded that RMA should deny reinsurance for 11 of the 17 nursery claims whose policies lacked the required documentation.[44]

[43] 7 *Code of Federal Regulations* (C.F.R.) 400.412(a), dated January 1, 2005.

[44] An AIP should also be performing preacceptance inspections when a producer's PIVR increases 50 percent or more from year to year [2005 *Nursery Crop Insurance Underwriting Guide*, §9.B(3), dated June 2004]. We found that the PIVR for one producer in our sample increased by 56 percent from CYs 2001 to 2002. RCIS should have performed a preacceptance inspection due to this increase, and it should have maintained that report in the file, but we found that this report was not present.

It should also deny reinsurance for two rehabilitation endorsements attached to two of those claims.[45]

RCIS Did Not Determine the Amount of Coverage Producers Should Receive in Accordance With RMA Requirements

For all 17 nursery claims, RCIS did not determine the amount of coverage producers should purchase in accordance with RMA requirements.[46] The required document for determining how much coverage nursery producers should receive, based on their inventory, is the PIVR. We found that RCIS did not verify the PIVR and producers could not support their reported plant inventory values when we requested that support. In other words, producers provided the agent with an estimate of their inventory values, and RCIS accepted liability for that estimate, without verifying the information submitted by the agent. This occurred because RCIS did not effectively underwrite these policies according to the terms of the Nursery Crop Insurance Program. Without verifying whether producers could support their PIVR, RCIS improperly accepted liability for 17 nursery claims that resulted in $65.6 million in indemnities.

Determining the amount of coverage producers should receive is one of the critical functions of underwriting for which AIPs take responsibility when they sign the SRA.[47] In order for insurance to attach and a policy to be issued under the Nursery Crop Insurance Program, nursery producers are required to submit a PIVR to RCIS by September 1.[48] The PIVR is used to determine how much coverage producers want to purchase and how much premium producers will pay. In order to determine the value of their inventory, producers are required to maintain documentation supporting their PIVRs, including a plant listing that includes the name, number, value, and size of each plant, and acceptable records of sales and purchases of plants for the three previous CYs.[49, 50] The PIVR is not an estimate. According to the SRA, AIPs may not estimate data for purposes of establishing premium, liability, or indemnity.[51]

During the course of our audit, we spoke repeatedly with the owners of the nurseries and their representatives. They told us that they did not maintain the documentation necessary to support the PIVR. In order to verify that producers had not performed a physical inventory in support of the PIVR, we

[45] A rehabilitation endorsement is additional coverage for field grown trees to cover expenditures for labor and materials for pruning and setup (righting, pruning, and staking) of damaged trees that have a reasonable expectation of recovery.
[46] We reviewed 17 nursery loss claims totaling $65.6 million and 2 rehabilitation endorsements totaling $760,623. Only the 17 nursery claims required PIVRs, but the 2 rehabilitation endorsements required a valid nursery policy. For simplicity's sake, wherever possible, we have referred to our sample as consisting of 19 claims totaling $66.3 million.
[47] 2005 SRA, §II.B, "Reinsurance," paras. (1) through (5), dated June 10, 2004.
[48] For CY 2006, RMA extended the date to October 31, 2005 (*Manager's Bulletin* MGR-05-017).
[49] The lower of the producer's best wholesale price or RMA's price is used to determine the value of the inventory.
[50] 99-073 Nursery Crop Provisions, §6(c), revised October 1998; 06-073 Nursery Crop Provisions, §6(c)(2), revised June 2005.
[51] 2005 SRA, §IV.B, "General Provisions," para. 9, dated June 10, 2004.

asked nursery owners to certify that they did not have inventory records supporting the value reported on their PIVRs. For 12 of the 17 nursery claims, producers certified that they had estimated their inventory's value. For two of the remaining five claims, the producer stated that he took a physical inventory to report the values on his PIVRs, but told us that he did not maintain records that support his plant counts and signed a certification of those statements. For the last three claims, the producer told us he took a physical inventory but did not maintain records. He refused to sign our summary-of-facts sheet without being represented by legal counsel. According to nursery crop insurance provisions, producers must maintain records to support their inventories for 3 years.[52]

We concluded that these 17 nursery claims lacked the support necessary for insurance to attach. Under the nursery crop provisions, the failure to provide such documentation when requested (or providing inadequate documentation) should result in denial of insurance for the crop year.[53]

When we spoke to officials at RCIS about the lack of support for these policies, they stated that the Nursery Crop Insurance Program is a self-certification program and that the producers should have maintained this documentation. A RMA senior official agreed that producers should have maintained this documentation, and insurance should not have attached without adequate support for the PIVR. Further, this official stated that RMA relies on the AIPs' due diligence to ensure that producers comply with program requirements. Therefore, we conclude that RCIS should not have issued policies that resulted in the 17 nursery claims and indemnities totaling $65.6 million.

We also noted that one of the producers we reviewed had purchased additional insurance for CY 2006 in the form of rehabilitation endorsements for his two nurseries. This producer received indemnity payments of $760,623 for pruning and straightening damaged trees. However, this additional compensation is contingent upon the producer first obtaining a valid nursery crop insurance policy. Since we question the validity of this producer's nursery policies due to a lack of support for his PIVR, we also question indemnities received for the two rehabilitation endorsements.

Overall, since none of the insurance policies should have attached due to RCIS failing to verify underwriting information and to maintain records of pre-acceptance inspections, we concluded that RCIS should not have paid indemnities totaling $66.3 million for the 19 CYs 2005 and 2006 claims we reviewed. However, RCIS' actions affected many more policies. RCIS allowed its agents to underwrite [ ] Florida CYs 2005 and 2006 nursery policies, with total liability of [ ] and total indemnities of

[52] 99-073 Nursery Crop Provisions, §6(c), revised October 1998; 06-073 Nursery Crop Provisions, §6(c)(2), revised June 2005.
[53] 06-073 Nursery Crop Provisions, §6(c)(3), revised June 2005.

[ ]. All of these policies should be denied reinsurance and should not be eligible for any indemnity payments.

Finally, when RCIS was granted the courtesy of reviewing an earlier draft of this report, company officials changed their explanation of how the company underwrites the policies it insures under the nursery program. RCIS has now provided to RMA documents that purportedly represent its underwriting process; we requested such documentation of RCIS' underwriting process repeatedly during the audit. RMA needs to remind RCIS that it is required to fully cooperate with Federal auditors and provide such information as requested.[54]

Recommendation 6

Direct RCIS to annually sample producers participating in the Nursery Crop Insurance Program and request support for the producers' PIVRs.

Agency Response

RMA concurred with this recommendation. RMA has issued Manager's Bulletin MGR-08-003 and MGR-08-003.1[55] directing all AIPs to perform the tasks contained in this recommendation. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with this recommendation, we need additional information before we can reach management decision. RMA's manager's bulletins provide a temporary requirement for AIPs to verify that producers have support for their PIVRs. These bulletins expire on December 31, 2009, without providing permanent corrective action. Furthermore, our review of MGR-08-013.1 found that it provides producers a 10-percent tolerance level between producers' PIVRs and their farming records, which in our opinion is not reasonable. For example, a policy for $65 million of plant inventory allows a producer a tolerance of $6.5 million, requiring no support for the difference in inventory between the physical plant inventory and the inventory reported on the PIVR. We discussed with RMA our concerns related to MGR-08-013.1. In these discussions, RMA officials assured us that RMA plans to implement a "zero tolerance" policy between the PIVRs and the producers' physical inventory beginning in 2010. To reach management decision, RMA needs to provide information (1) extending the manager's bulletin requiring the AIPs to confirm that producers' PIVRs are supported by the required farming records until RMA permanently corrects

[54] 2005 SRA, §IV.G, "Access to Records and Operations," para. (1) and (7), dated June 10, 2004.
[55] The correct manager's bulletin citation should be MGR-08-013.1, issued October 29, 2008, superseding MGR-08-013.

this problem and (2) provide a specific timeframe to implement its permanent corrective action.

Recommendation 7

Direct RCIS to retain preacceptance inspection reports for all nursery producers actively insured in each crop year.

Agency Response

RMA concurred with this recommendation. Based on the existing regulations (specifically the definition of "Policy" in the Basic Provision of Insurance), pre-acceptance inspection would be a part of the "accepted application" and required to be retained with the policy from year to year until the policy is cancelled. Based on the audit findings, it is clear that some in the crop insurance industry failed to recognize this requirement. To that end RMA will change the Nursery Underwriting Guide to clarify the requirement and ensure all AIPs retain the inspection reports with application while the policy is active and without regard to the 3-year retention requirement of the SRA. RMA will implement the change to the Underwriting Guide not later than January 2010. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with the recommendation, we need additional information before we can reach management decision. RMA agreed to change the nursery policy requirements to require that the pre-acceptance inspection report be maintained as part of the "accepted application" and as a permanent document with the policy from year to year until the policy is cancelled. While this is a positive step for the future, it does not correct the present condition. To reach management decision, RMA needs to immediately issue a manager's bulletin that requires all AIPs to maintain producer pre-acceptance inspection reports as part of policy documentation. The manager's bulletin should remain in effect until changes are incorporated into the Nursery Underwriting Guide.

Recommendation 8

Recover $5,727,137 in indemnity payments paid by RCIS to the nursery that was not eligible for insurance coverage.

Agency Response

RMA conditionally agreed with this recommendation pending further analysis and evaluation of this matter. RMA's Eastern Regional Compliance Office (ERCO) has opened a case and will complete a review of the above

matter. If the ERCO determines there is a monetary discrepancy due to erroneous determination, RMA will cite RCIS, establish an accounts receivable and collect any monies owed from RCIS. RMA requests management decision for this recommendation.

OIG Position

Although RMA conditionally agreed with this recommendation, we need additional information before we can reach management decision. RMA needs to provide OIG with copies of ERCO's final determination for the questioned indemnity payments (including copies of the accounts receivable established) or its justification for not pursuing the questioned indemnity payments.

Recommendation 9

Validate that RCIS has implemented an underwriting process that meets the requirements of the Federal Crop Insurance Program. Additionally, document and report to OIG any changes to the RCIS underwriting process since OIG's review.

Agency Response

RMA concurred with this recommendation. Since OIG's review, RMA conducted a review of RCIS's underwriting processes and found they are sufficient to meet the requirements of the Federal Crop Insurance Program. A briefing outlining the findings and results of this review was provided to your audit staff. The information and documentation from the review was presented to the auditors, and questions or concerns were addressed over a 3-day period of time. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with this recommendation, we need additional information before we can reach management decision. During RMA's briefing to OIG, RMA officials stated that their review of RCIS' underwriting processes was ongoing and had not been completed. We have not been provided a copy of the review results. RMA provided us with some documents that it had obtained from the AIP; however, our analysis of this documentation determined that these SOPs were published *after* CYs 2005 and 2006. To reach management decision, RMA needs to provide OIG with a copy of its completed review of the AIP's underwriting process. That review should address whether an underwriting process has been implemented that meets the requirements of the Federal Crop Insurance Program and identify any changes to the AIP's underwriting process since OIG's review.

Finding 3 RCIS' Agent Allowed Significant Deviations From RMA Policies and Procedures While Writing Policies

During CYs 2005 and 2006, one agent wrote [ ] of the [ ] of Federal crop insurance policies sold by his agency, which is [ ] percent of RCIS' [ ] book of business for the Nursery Crop Insurance Program in Florida. This agent wrote the policies for 17 (15 nursery and 2 rehabilitation endorsements) of the 19 claims we reviewed. We found that this agent made four serious deviations from RMA's nursery crop policies and procedures when he wrote the policies for these 17 claims: (1) he improperly assisted producers in estimating the value of their inventories reported on the PIVR and accepted their estimated PIVRs, (2) he did not inform producers of recordkeeping requirements, (3) he sold peak inventory endorsements in excess of the number allowed in the Nursery Crop Insurance Program, and (4) he sold peak inventory endorsements to cover periods of increased risk rather than for periods of increased inventory. This occurred because RCIS did not verify that policies were written in accordance with nursery crop insurance provisions. Given the seriousness of the noncompliance we found, we question whether insurance should have attached to policies written by this agent for the 17 sampled claims. We further question whether the agent's and his agency's book of business totaling [ ] in Florida nursery crop insurance policies should have been reinsured by RMA.

When AIPs sign the SRA, they enter into a contractual obligation to ensure that all of their employees—as well as their agents—comply with the SRA.[56, 57] When this agent signed his contract with RCIS, he agreed that he would not "violate the duties imposed on agents by the SRA" or cause RCIS "to breach or violate the terms of the SRA."[58]

We found, however, that this RCIS agent made four serious errors when writing policies for the Nursery Crop Insurance Program, and that the results of these errors breached the SRA.

RCIS' Agent Improperly Assisted Producers in Estimating Inventory Values for Their PIVR

According to the nursery crop insurance provisions, the amount of insurance coverage at any time during the crop year is based on the value of the nursery's inventory reported on the PIVR. Producers are required to maintain

[56] Agents are independent contractors, not employees.
[57] 2005 SRA, §I, "Definitions," and §II(A), "General Terms," para. 6, dated June 10, 2004.
[58] RCIS' Agent Contract form MP-9500 (12-04) signed on November 22, 2004.

documentation in support of their PIVRs, including a detailed inventory listing that includes the name, number, and size of plants.[59]

The PIVR is not an estimate, but rather an actual inventory supported with adequate documentation.[60] According to the SRA, AIPs may not estimate data for purposes of establishing premium, liability, or indemnity.[61]

We found, however, that one RCIS agent encouraged producers to estimate inventory values reported on their PIVRs. Although this agent stated that producers provided him the inventory values reported on their PIVRs, the producers have certified in writing to OIG that they estimated their inventory values with the agent's assistance and that they did not have records to support their PIVR values.[62] When we discussed the certifications with the agent, he told us that the PIVR is, in essence, an estimate, that the majority of nursery producers do not have a recordkeeping system in place to tell them exactly how many of each plant they have on hand week to week or month to month. He also stated that the inventory for most growers changes dramatically throughout the year, and that the reality is that it is difficult for them to keep up with inventory changes. OIG notes that producers' inventory values may change dramatically during the year, which is even more reason for the AIP to ensure that producers document their plant inventories.

We subsequently obtained a letter documenting what the actual business practice was at this insurance agency. As the agency later informed USDA, it operated according to the principle that "growers were not required to provide detailed plant inventories to apply for crop insurance in CYs 2005 and 2006. *Only an estimate of total inventory value was necessary* (OIG's emphasis)". This business practice contradicted the terms of the SRA[63], as well as RMA's nursery crop provisions.[64]

By assisting the producers in estimating their PIVRs, the agent allowed them to understate their inventory on hand at the time of policy renewal, thereby lowering the crop insurance premiums they would pay. We found that for 11 of the 17 nursery claims, producers reported more inventory value on hand at the time of the hurricanes than they had reported on their PIVRs. For example, producer B reported on his PIVR a plant inventory value of $2,558,620 on September 27, 2005. Hurricane Wilma struck 27 days later on October 24, 2005. The loss adjuster determined that the producer had a plant inventory of $4,483,248, a difference of $1,924,628. By underreporting their

[59] 99-073 Nursery Crop Provisions, §6, revised October 1998, and 06-073 Nursery Crop Provisions, §6, revised June 2005.
[60] 99-073 Nursery Crop Provisions, §6(c), revised October 1998, and 06-073 Nursery Crop Provisions, §6(c)(2) revised June 2005.
[61] 2005 SRA, §IV.B, "General Provisions," para. 9, dated June 10, 2004.
[62] See Finding 2.
[63] 2005 SRA, §IV.B, "General Provisions," para. 9, dated June 10, 2004.
[64] 99-073 Nursery Crop Provisions, §6(c), revised October 1998, and 06-073 Nursery Crop Provisions, §6(c)(2), revised June 2005.

inventories in this way, producers in our sample underpaid approximately $194,000 in insurance premiums.[65]

In addition, producers did not report values on their CY 2006 PIVRs for all the insurable plant types grown in the nursery. According to one producer, his agent told him that he could list only one plant type on the PIVR and that all plant types were insured under a basic unit by share type policy. However, the nursery crop insurance provisions state that the plant inventory values for each plant type must be separately reported on the PIVR.[66] For 6 of the 9 CY 2006 claims for policies that were written by this agent, producers claimed losses on 15 plant types that were not reported on their PIVRs and that were, therefore, uninsured.[67,68] We computed premiums for these 15 plant types and found that producers should have paid an additional $86,000 in premiums if the 15 plant types had been insured. In Finding 4, we describe how producers received $3.7 million in indemnities for plant types that were not insured.[69]

We concluded that this agent's actions were not in compliance with the nursery program policies and procedures. The agent thereby contributed to the lack of documentation for producers' PIVRs when RCIS accepted liability for these policies.

RCIS' Agent Did Not Inform Producers of Their Recordkeeping Requirements

Agents not only sell insurance policies, they also service the policies they sell.[70] As part of servicing those policies, agents are required to inform producers of their recordkeeping requirements.[71]

We found that the agent did not inform producers that their crop insurance policy required them to maintain records supporting their PIVRs and their changing inventory values. When we spoke to the agent about his role in providing service to the producers, he told us that producers are informed of the recordkeeping requirement when the policy is originally issued, in renewal letters that he mails to producers annually, and that he verbally reminds producers each year that documentation may be required upon

[65] *2005 Nursery Crop Insurance Underwriting Guide*, §11(A), dated June 1, 2004; *2006 Nursery Crop Insurance Underwriting Guide*, §12(A), dated August 19, 2005. Ultimately, underestimating their inventories may have harmed producers' interests. Nursery crop insurance handbooks require that if the producer fails to report a value of inventory on the PIVR at least equal to the value of the inventory at the time of any loss determination, a penalty in proportion to the amount of underinsurance will be applied. We estimated that these underreporting penalties cost these producers $3.3 million in indemnities had they reported their PIVR values in an amount at least equal to the value claimed at the time of loss.
[66] 06-073 Nursery Crop Provisions, §6(c)(1), revised June 2005.
[67] For 10 of the 12 additional claims we reviewed for Finding 7, we found that producers claimed losses on 24 plant types that were not reported on their PIVRs.
[68] See Finding 4.
[69] In Finding 7, we discuss how producers received an additional $990,541 in indemnities for plant types that were not insured.
[70] 2005 SRA, §I, "Definitions," dated June 10, 2004, defines "agent" as an individual licensed by the State in which an eligible crop insurance contract is sold and serviced for the reinsurance year, and who is under contract with the company, or its designee, to sell and service such eligible crop insurance contract.
[71] *2005* and *2006 Crop Insurance Handbook*, Federal Crop Insurance Corporation-18010, §5(A)(1), dated June 28, 2004, and June 30, 2005.

request. He told us that perhaps the producers' interpretation is that if nobody questions the amounts they report on their PIVRs, they can get rid of their records. He also said that, though he explains the requirements to them each year, it may not be clear to them that they have to keep the documentation for 3 years. He further said that all producers are provided a copy of the nursery crop provisions and thus should be aware of all program requirements. An RCIS Compliance official, however, agreed with OIG that producers do not read the provisions.

We asked the producers if they had been informed of their policy's recordkeeping requirement. They stated that they depend upon their agent to explain the policy, but that he had not informed them of the need to keep records, and that they were unaware of this requirement until OIG requested records and brought the requirement to their attention. Further, producers stated that this lack of records had not been a problem in prior claims they had filed and loss adjusters had not requested any documentation.

The agent could not provide any evidence, including renewal letters, demonstrating that he had informed producers of this important policy requirement. By not doing so, the agent contributed to the lack of documentation that characterized these policies.

RCIS' Agent Sold Peak Endorsements to Cover Periods of Increased Risk Rather Than Increased Inventory

Producers may purchase peak endorsements to temporarily increase their insured values during peak periods of inventory. Peak endorsements are designed to be used as a risk management tool for covering periods of peak inventory, not for covering periods of increased risk such as the hurricane season.[72]

We found, however, that the agent wrote peak endorsements for additional coverage during hurricane season rather than for periods when producers' actual inventory peaked. For instance, one producer's coverage for field-grown trees doubled during hurricane season—from $22.5 million to $45 million for CY 2005 and from $27.5 million to $55 million for CY 2006—even though he could neither explain nor produce any records that demonstrated his actual inventory had doubled during the peak endorsement periods. Another producer told us that he purchased crop insurance to protect primarily against hurricane damage because he has taken adequate measures to protect his plants against drought, freeze, insect, and disease.

The agent stated that he did use peak endorsements as a risk management tool to cover producers' inventories during hurricane season. He said that RCIS

[72] *2005 Nursery Crop Insurance Underwriting Guide*, §14, dated June 1, 2004, and *2006 Nursery Crop Insurance Underwriting Guide*, §15, dated August 19, 2005.

officials had told him that there is no specific language that states that he could not use peak endorsements to increase coverage during hurricane season for actual inventory. Nursery crop insurance policy does not, however, allow this use of peak endorsements, especially since the practice involved underreporting inventories during the rest of the year.[73]

We concluded that the agent misused peak endorsements as a way of lowering the premiums producers would pay. We found that this agent sold 20 peak endorsement policies for 11 of the nursery claims we reviewed, and that none of the endorsements were supported by producers' inventory records. These unsupported endorsements resulted in producers underpaying their proper premium by $668,000 for both crop years.[74]

RCIS' Agent Wrote Improper Third Peak Endorsements

For CY 2005, the nursery crop insurance policy permitted only two peak endorsements, unless there had been a loss and a restocking of plants.[75] Unlike the PIVR, no revisions are permitted to existing peak endorsements once they are issued.[76]

We found, however, that the agent sold improper third peak endorsements covering 3 of the 17 nursery claims we reviewed to better cover producers during the hurricane season, even though there had been no loss and restocking of plants.[77] For example, one producer wanted to buy additional insurance because he had acquired a new property and wanted to extend coverage an extra month on another property. The agent improperly issued two third peak endorsements to accommodate the producer's request. These improperly written third peaks resulted in improper indemnities totaling $6.6 million, as discussed in Finding 4.

Through data mining, we found that the agent also improperly sold more than two peak endorsements for an additional four CY 2005 policies. In order to make the determinations that the third peak endorsements were improper, we obtained documentation from the agent's files relating to these additional policies.

When we discussed this problem with the agent, he agreed that only two endorsements were allowed for CY 2005, but stated that he was allowed to "revise" the second peak endorsement because it was not yet in effect, and

[73] *2005 Nursery Crop Insurance Underwriting Guide*, §14, dated June 1, 2004, and *2006 Nursery Crop Insurance Underwriting Guide*, §15, dated August 19, 2005.
[74] To arrive at this conclusion, we combined the PIVR and peak inventory values reported and computed the premium on the combined amount as though it was the PIVR amount.
[75] 99-073A, Nursery Crop Provisions Peak Inventory Endorsement, para. 2(d), dated October 1998.
[76] *2005 Nursery Crop Insurance Underwriting Guide*, §14, dated June 1, 2004, and *2006 Nursery Crop Insurance Underwriting Guide*, §15, dated August 19, 2005.
[77] We reviewed three of the 7 claims affected by improper third peak endorsements. Data mining identified another 4 claims, which we confirmed with the agent.

that was what he had done. He also stated that RCIS officials told him he could revise the second peak endorsement if he was increasing the original peak endorsement. OIG and RMA disagree with this argument—the agent's revisions to second peak endorsements constitute third peak endorsements, and they should not have been written.

We concluded that the agent violated his responsibilities for selling and servicing policies in accordance with the policies and procedures of the Nursery Crop Insurance Program. If an agent willfully violates the terms of the SRA in a way that seriously affects the integrity of the crop insurance program, RMA may debar that agent.[78] Based on our review of this agent's improper actions, we recommend that RMA debar the agent from selling and servicing any insurance policy reinsured under the Federal Crop Insurance Program.

Recommendation 10

Initiate a review to determine if this agent's actions were willful and, if they were, debar this agent from participating in the Federal Crop Insurance Program.

Agency Response

RMA conditionally agreed with this recommendation pending further analysis and evaluation of this matter. Within the next year, the ERCO will open a case and complete a review of the actions by the above agent. The results of this review will be utilized by RMA to determine appropriate future actions. RMA requests management decision for this recommendation.

OIG Position

Although RMA conditionally concurred with this recommendation, we need additional information before we can reach management decision. RMA needs to provide OIG with a copy of the results of its review of the agent's actions and its determination of any actions to be taken against the agent, including a timetable for completing any actions against the agent.

[78] Title 7, C.F.R., 3017.800(b)(1), dated January 1, 2005.

For the 19 claims[79] we reviewed, we found a systematic pattern of errors, noncompliance, and ineffective reviews in RCIS' claims process. Of the $66.3 million in indemnities paid on these claims, RCIS issued at least $10,644,328 in overpayments and underpaid producers by at least $466,221. When a producer reports a loss on a Federally reinsured crop policy, it is the AIPs' responsibility to accurately determine and independently verify the magnitude of that loss and calculate an indemnity according to RMA's policies and procedures.[80]

We found, however, that RCIS was not able to adequately perform this basic responsibility. This deficiency was not simply a matter of loss adjusters making computational or procedural errors, although they made multiple such errors on every claim we reviewed. They also did not fulfill the most fundamental requirements of adjusting losses—they did not verify that producers were eligible to claim losses; they did not independently determine the damage producers had suffered, they did not correctly apply RMA policies and procedures, and they did not document their loss determinations.

RCIS' deficiencies during the loss adjustment process went well beyond the errors loss adjusters made in the field. More critically, RCIS had not established adequate management controls or assigned sufficient resources to properly adjust nursery loss claims in Florida. Although each of the claims we reviewed was subjected to RCIS' quality control review, that review did not detect the problems we found with producers' eligibility or the loss adjusters' errors.

Finally, we found that RCIS management directly contributed to loss adjustment errors by developing and disseminating an unauthorized procedure for dealing with damage caused by multiple hurricanes. This unauthorized procedure contradicts RMA's established procedures and resulted in overpayments totaling $409,977 and underpayments totaling $569,969 for 5 of the 17 nursery claims we reviewed.[81] RCIS management issued this unauthorized procedure even after RMA had twice provided the company direct and clear guidance on how to adjust for damage from multiple storms.

[79] Of the 19 claims reviewed, 17 were nursery claims and 2 were rehabilitation claims.
[80] 2005 LAM, part. 1(7)(A) through (B), dated July 12, 2005; 2005 SRA §IV, "General Provisions," F(1)(a) through (c), dated June 10, 2004.
[81] Net results of loss adjuster errors for computing losses using unauthorized procedures are included in total overpayments of $10,644,328 and underpayments of $466,221.

Finding 4 RCIS Adjusters Failed to Effectively Perform Their Loss Adjustment Responsibilities, Resulting in Significant Errors and Noncompliance

For the 19 claims we reviewed, RCIS adjusters made significant errors and did not comply with RMA's loss adjustment policies and procedures when adjusting these loss claims. This occurred because RCIS had not provided its adjusters with standard operating procedures (SOP) to follow when determining losses. Even though they had received training on Federal Crop Insurance Corporation nursery policies and procedures, the adjusters did not always follow RMA's policies and procedures. Additionally, the AIP lacked a contingency plan for ensuring that it could deploy sufficient numbers of competent and experienced loss adjusters to handle claims resulting from the hurricanes. RCIS adjusters made serious errors at all phases of the loss adjustment process and issued overpayments totaling $10,644,328 and underpayments totaling $466,221 (see exhibit B).

When producers suffer a loss, adjusters are responsible for visiting their fields and determining their losses. RMA provides policies and procedures for all phases of the loss adjustment process. As specified in the SRA, LAM, and LASH, adjusters must (1) verify that producers are eligible to claim losses, (2) independently determine the extent of the damage the producer suffered, (3) apply nursery crop insurance policies and procedures to calculate the indemnity owed to the producer, and (4) document the process they used to compute the payment the producer will receive. All of these phases must be properly completed to correctly adjust a loss.

We found, however, that RCIS adjusters did not perform essential steps during the loss adjustment process for all 19 claims reviewed. Exhibit B details each claim by error type and the erroneous payments that resulted from the error.

RCIS Adjusters Did Not Verify Producers' Eligibility for Crop Loss Claims

When producers file a claim for loss, adjusters must first verify that producers are eligible to claim losses under the Nursery Crop Insurance Program. The AIP provides its adjusters with the schedule of insurance—a document that details the values a producer has reported on his PIVR. Adjusters must then verify that the producer has support for these reported inventory values. They should also obtain and verify that other insurance documents, including the peak and price endorsements, are valid.[82] If

[82] A peak endorsement is an additional inventory value that is allowed for a basic unit during a specific time. A price endorsement is an upgraded plant price approved by the AIP when elected by the insured. A schedule of insurance is a document that adjusters receive as part of the claim file that informs them of the coverage that the producer has elected.

adjusters find that producers lack support for their inventory, then the adjusters should deny those claims.[83]

For all 17 nursery claims, however, we found that RCIS adjusters did not verify that producers were eligible to claim losses prior to beginning the loss adjustment process. Adjusters told us that they did not consider verifying such information a requirement of their job. Although adjusters received a schedule of insurance from RCIS, they did not request from producers support for the inventory values insured. If they had requested this documentation, they would have learned that these producers were not maintaining adequate farming records.

To verify before-loss inventory values, we attempted to roll forward two producers' inventories from their last physical inventory to October 2005.[84] For producer A, we reviewed purchase orders, shipping documents, receiving reports, import documents, sales invoices, and sales and purchase journals, but we could not substantiate the inventories the producer claimed to have on hand at the time of the hurricanes. Producer E maintained verifiable sales records but did not maintain potting reports of coconut seeds and other plants, so we were unable to determine when trees were planted in the field and how tall (stage of growth) they were when they were planted—data necessary to determine the age and size of the trees. Also, producer E could not support large increases in inventory that he claimed took place between Hurricanes Katrina and Wilma.

We also found that RCIS loss adjusters did not obtain and verify insurance documents relating to additional crop insurance coverage through peak and price endorsements. If they had done so, they would have found that these endorsements were not valid, and that those claims for crop loss should be denied. For three of seven CY 2005 nursery claims with peak endorsements, adjusters computed loss determinations involving an invalid third peak endorsement—these invalid third peak endorsements resulted in $6.6 million in overpayments.[85]

Similarly, for one claim, an adjuster did not determine if producer C's price endorsement was supported by actual plant sales. We found that the producer could not provide records to support sales at the higher endorsed price. The adjuster's error resulted in an overpayment of $374,794.

By not verifying that producers were eligible to claim losses, RCIS loss adjusters overlooked one of the fundamental responsibilities for adjusting loss claims.

[83] 06-073 Nursery Crop Provisions, §6(c)(3), revised June 2005.
[84] Producer A's bank required that he perform a physical inventory in June 2005. Producer E's certified public accountant performed a physical inventory in March 2005 for financial statement reporting.
[85] We reviewed 7 CY 2005 nursery claims, 10 CY 2006 nursery claims, and 2 CY 2006 rehabilitation claims, for a total of 19 claims.

RCIS Adjusters Did Not Independently Determine Damage to Producers' Crops

Once loss adjusters have verified that producers are eligible to claim losses, adjusters must then independently determine what damage the producers suffered. To do this, they should use producers' records to establish a verifiable number of insured plants prior to the hurricane. Adjusters should then walk the fields and independently determine how many plants were damaged and the extent of the damage. Establishing before-loss inventory values for nursery plants differs from establishing before-loss values for other crops because acreage reports that are available for most other insured crops are not available for nursery plants. For this reason, more reliance is placed on the PIVR. If an adjuster finds that a producer cannot provide adequate records of the number of plants on hand **immediately prior to** (OIG emphasis) the occurrence of any loss, the adjuster may obtain support for the PIVR and use producer's records to roll inventory forward until the date of the damage. If the PIVR cannot be supported, then the claim should be denied.[86]

For the 17 nursery claims, we found that RCIS loss adjusters did not independently verify the inventory producers told them they had on hand immediately prior to the hurricanes. Without independent verification, adjusters accepted what the producers provided and used that information to calculate the indemnity for 97 percent of the inventory recorded on nursery appraisal worksheets.[87]

When adjusters visited nurseries, they could not verify the producers' inventories, and they could not assess the damage because producers did not maintain sufficient farming records. Instead of denying the claims, however, adjusters accepted producers' *estimates* of the number of undamaged plants prior to the hurricane, the number of plants damaged by the storms, and the extent of the damage (including the growth of the plant). All of these estimated inventories were prepared after the storms had struck the nurseries and were not supported by farming records prepared before the loss. For example:

- One adjuster, while determining losses for Hurricane Rita, did not question producer A's estimate of 223,681 2-gallon Boston ferns and the damage to them, and calculated the indemnity accordingly. However, before Hurricane Wilma struck, the producer had moved 60,000 of the ferns to another property, but had not revised his estimate and did not tell the loss adjuster about the movement. When

[86] 06-073 Nursery Crop Provisions, §6(c)(3), revised June 2005; 2000 LASH, §4(G), dated February 14, 2000; and 2006 Nursery LASH, §7(G)(1)(2), dated November 16, 2005.

[87] Ninety-seven percent is for 13 of 17 nursery claims. The other four nursery claims did not have insured provided inventories to compare. For the other 3 percent of the inventory counts, loss adjusters reported slightly revised counts.

the adjuster visited the nursery to determine losses due to Hurricane Wilma, he did not verify that the producer only had 163,681 2-gallon Boston ferns on hand. As a result, the adjuster included these 60,000 plants in the indemnity amount to be paid.

- Satellite images, obtained by RMA, showed 1,757 trees in one of producer E's fields just 2 days after the hurricane; however, producer E and his adjuster reported 4,322 trees in this field. We concluded that the adjuster could not have arrived at the sum of 4,322 trees by performing an independent count. Because this loss adjuster did not count these trees, the producer was indemnified for 2,565 trees that did not, according to satellite images, exist.

Loss adjusters did not independently determine producers' losses and accepted, 97 percent of the time, estimates of before-loss inventories that were prepared by producers after the hurricanes struck. Their use of unverified inventory estimates constituted a serious breakdown in the loss adjustment process.

RCIS Adjusters Did Not Correctly Apply Nursery Crop Insurance Policies and Procedures

After adjusters have verified producers' eligibility and independently determined the extent of the damage producers' crops suffered, they then must calculate the indemnity, following loss adjustment policies and procedures as set forth in RMA's handbooks. If adjusters are unsure of how an indemnity should be calculated, they should then seek clarification from the AIP.

For all 19 claims, we found that adjusters did not correctly apply nursery program loss adjustment policies and procedures. For example, for six of nine CY 2006 nursery claims reviewed, RCIS adjusters calculated indemnities for plant types that producers did not list on their PIVRs and were not listed on the schedule of insurance.[88] In other words, they included losses for plants that were not insured. Adjusters made this error because they did not correctly apply changes in the CY 2006 nursery crop program. In CY 2006, the policy required an inventory by plant types, whereas in CY 2005, the inventory was by practice.[89] Their errors resulted in overpayments totaling $3.7 million.

For 7 of 17 nursery claims, we found that loss adjusters did not use the lower of producer's wholesale catalog price or RMA's price, as required by nursery policies and procedures. Due to the errors, RCIS issued overpayments totaling $302,908 and underpayments totaling $18,256.

[88] We reviewed 7 CY 2005 nursery claims, 10 CY 2006 nursery claims, and 2 CY 2006 rehabilitation claims for a total of 19 claims.
[89] A practice is a cultural method of producing nursery plants. Container grown and field grown are considered separate insurable practices.

When we asked adjusters why they did not correctly apply nursery program policies and procedures, they stated that policies and procedures were very different for CY 2006, and they did not realize that they had adjusted the losses incorrectly. We noted, however, that these adjusters had received the required training hours.

RCIS Adjusters Did Not Document the Process They Used to Determine the Damage Producers' Crops Suffered and Compute the Payment

Adjusters must document how they arrived at their determinations in sufficient detail so that subsequent reviewers can verify their conclusions. This phase is crucial because subsequent reviews—including AIP reviews required by the SRA, RMA reviews, and OIG reviews—rely on this documentation. It is also particularly important because nursery inventories are constantly changing—a visit to a nursery as soon as one month after a hurricane will find that the inventory no longer resembles what it was immediately after the storm. If there is not adequate documentation to support an adjuster's conclusions at the time of the loss, then subsequent reviewers will not be able to determine the propriety of any claims paid.

For all 19 claims, loss adjusters did not fully document their process for determining producers' damage. We reviewed available documentation for each claim file, found significant gaps in the documentation, and could not confirm adjusters' conclusions. When asked why they did not provide adequate documentation for their determinations of loss, adjusters stated that they were required only to complete the nursery appraisal worksheet and that this worksheet served as their documentation. Although completion of the nursery appraisal worksheet is part of the documentation process, we found that this worksheet is only a statement of the determination of damage, and not a detailed explanation of how that determination was arrived at. Without more substantial documentation, we could not determine the propriety of loss determination and the resulting indemnities.

For one claim, the adjuster told us that in order to verify 495,000 damaged Boston ferns that producer A had dumped into one large pile, she counted the pots that the producer had left around the pile of dumped plants. Producers must place Boston ferns off the floor, and many producers, including producer A, meet this requirement by placing the ferns on another pot turned upside down. In essence, that means a producer would have two pots for each Boston fern. The adjuster took no pictures to support her totals and she had not documented her methodology in the claim file.

For another claim for producer E, the adjuster told us that she visited 53 fields that totaled 1,359 acres and independently counted 354,749 trees. She verified the heights of trees, many of them over 18 feet tall, and determined that 45,501 trees were dead, 94,252 would never completely

recover, and 206,317 were damaged but would fully recover sometime in the future. The adjuster said that she counted all the trees and assessed the damage in just 6 days. In addition, this adjuster grouped trees by type and height and reported each group as one line item on the nursery appraisal worksheet without consideration for growing location. She did not, however, document the process she used. By grouping trees across fields, she made it impossible to determine the field location for specific damaged trees.

By failing to document how they arrived at their determinations, RCIS adjusters compromised the effectiveness of the oversight process RMA has established to ensure the integrity of the Nursery Crop Insurance Program.

In all four phases of the loss adjustment process, RCIS loss adjusters did not perform critical functions, including verifying that producers were eligible to claim losses, independently determining how much damage producers suffered, adjusting the indemnity according to nursery policies and procedures, and comprehensively documenting how they arrived at their loss determinations. Widespread failure in all 4 phases and for all 19 claims indicates systematic problems in RCIS' administration of the Nursery Crop Insurance Program.

Ultimately, RCIS' loss adjusters failed to adjust these loss claims adequately because the AIP did not provide them with SOPs for the loss adjustment process. Officials at RCIS stated that they regarded RMA's LAM as their overall SOP, and then RMA's LASH as their specific SOP for the Nursery Crop Insurance Program. They did not feel the need to develop additional SOPs. We concluded that, since RCIS has contracted to participate in the Federal Crop Insurance Program, it must be prepared to fulfill its contractual responsibilities. Its loss adjusters were unable to comply with the LASH and the LAM, and it must therefore provide them with additional guidance in the form of SOPs.

RCIS also lacked a contingency plan for dealing with disasters on the scale of the 2005 hurricanes. RCIS officials explained that they had not developed a plan because their routine business is responding to disasters and they therefore did not need a plan. RMA, however, has stated that it relies on AIPs to develop a contingency plan for responding to disasters. We concluded that RCIS' handling of the 2005 Florida hurricanes would have been improved if the company had developed a disaster contingency plan that involved mobilizing a sufficient number of trained adjusters and other personnel.

Because RCIS did not adjust for losses as required by the SRA, LAM, and LASH, we believe that the AIP breached the terms of its agreement with RMA and was not responsibly administering the Nursery Crop Insurance Program. Additionally, these errors resulted in overpayments totaling $10,644,328 and underpayments totaling $466,221.

Recommendation 11

Recover $9,417,235[90] in loss adjustment overpayments from RCIS and direct RCIS to pay producers underpayments totaling $466,221.[91]

Agency Response

RMA conditionally agreed with this recommendation pending its further analysis and evaluation. The ERCO has opened a case and will complete a review of the above matter. If the ERCO determines there is a monetary discrepancy due to erroneous determinations, RMA will cite RCIS, establish an accounts receivable and collect any monies owed from RCIS. RMA requests management decision for this recommendation.

OIG Position

Although RMA conditionally concurred with this recommendation, we need additional information before we can reach management decision. RMA needs to provide OIG with copies of its final determinations for all questioned indemnity payments (including copies of the accounts receivables established) or its justification for not pursuing the questioned indemnity payments.

Recommendation 12

Direct RCIS to develop and implement a comprehensive set of SOPs for the loss adjustment process. Those SOPs should include guidance for handling the errors identified in this report, including verifying that producers are eligible to claim losses. Distribute these SOPs to loss adjusters working for the company, and incorporate them into the company's annual training curriculum.

Agency Response

RMA concurred with this recommendation. In response to the OIG audit report, RMA directed RCIS to provide a comprehensive set of SOPs regarding its nursery loss adjustment process. RCIS contends that these SOPs are more rigorous than those in effect for the eligible crop insurance contracts that were subject to the OIG review and fully comply with current RMA procedures. However, the sufficiency of these procedures and their incorporation into training materials will be determined through RMA's independent investigation. If RMA determines that RCIS's procedures are

[90] To avoid double counting of the payment errors, we deleted from the total dollar of adjuster errors in exhibit B the adjuster errors for claim nos., 15 and 19, since we already questioned the nursery's eligibility for insurance and recommended recovery of the full indemnity payments in Recommendation 8.

[91] If, in response to Recommendations 2 and 3, RMA makes a determination to deny reinsurance and, therefore, any indemnity payments relating to the reinsurance for all of RCIS' nursery policies (or only for policies involving the 19 reviewed claims), RMA does not need to pursue recovery of the specific questioned amounts identified as loss adjustment errors in this finding.

inadequate or if the SOPs are not properly incorporated into training, RCIS will be directed to take appropriate corrective action. RMA expects to complete this action by January 2010. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with this recommendation, we need additional information before we can reach management decision. RMA needs to provide OIG with copies of RCIS' SOPs and RMA's review and determination of the adequacy of RCIS' SOPs, including any additional actions to be required of RCIS and the expected timetable for RCIS' completion of these additional actions.

Recommendation 13

Direct RCIS to develop a disaster contingency plan for handling large-scale disasters.

Agency Response

RMA concurred with this recommendation. In response to the OIG draft audit report, RCIS provided RMA with a description of its procedures for handling large-scale disasters, including such contingencies that would require the activation of "travel teams." Consequently, RCIS has complied with this recommendation. RMA requests management decision for this recommendation.

OIG Position

Although RMA concurred with this recommendation, we need additional documentation before we can reach management decision. RMA needs to provide OIG with the AIP's procedures for handling large-scale disasters, including contingency plans.

Finding 5 — RCIS' Quality Control Review Process Did Not Detect and Prevent Serious Adjuster Errors and Noncompliance

RCIS performed quality control reviews for claims over $100,000, but those reviews did not identify all noncompliance problems and errors, especially errors relating to producers' eligibility. RCIS' quality control reviewers did detect some procedural and computational errors, but for all 19 claims we reviewed, they did not review the underlying eligibility of claims, detect numerous loss adjuster errors, or maintain their independence from the loss

adjustment process. This occurred because RCIS was not prepared for disasters on the scale of the 2005 hurricanes, and did not have a contingency plan for mobilizing sufficient numbers of trained reviewers. Their efforts to review claims were hindered by the fact that the adjusters did not provide adequate documentation for their loss determinations.[92] The inadequacy of RCIS' quality control reviews contributed to $10,644,328 in overpayments and $466,221 in underpayments.

When AIPs sign the SRA, they agree that they will review all claims in excess of $100,000 and report the results to RMA.[93] These quality control reviews are intended to focus on verifying information pertaining to how the policy was underwritten and how the loss was determined.

In fulfillment of this requirement, RCIS issued a handbook that sets forth guidelines on how to conduct quality control reviews. The handbook required RCIS' quality control reviewers to begin by verifying that the policyholder's information is correct and that the policy is an eligible crop insurance contract. Quality control reviewers were required to verify the producer's PIVR, schedule of insurance, and planting and sales records. They also were to verify that the adjuster had correctly determined the producers' losses.

Since all 19 claims we reviewed exceeded $100,000, they were all subject to the quality control review required by the SRA. RCIS performed these reviews, but we found that the AIP's reviews did not detect and correct the serious underwriting and loss adjustment errors we identified.

RCIS Quality Control Reviewers Did Not Verify Producers' Eligibility for Insurance

RCIS' handbook for the quality control review acknowledges that, to be effective, a review must begin by verifying the producer's eligibility for insurance, which, of necessity, should include a review of relevant underwriting documents. We found, however, that quality control reviewers did not verify the producers' eligibility or important underwriting documents such as the PIVR. Reviewers explained that they primarily focused on reviewing the calculations adjusters made when determining losses. This focus on loss adjuster calculations meant that quality control reviewers did not detect the serious noncompliance problems with how these policies were underwritten, as discussed in section 2 of this report.

[92] See Finding 4.
[93] 2005 SRA, app. IV, §III, "Quality Control Guidelines," A - "General Company Responsibilities," pars. 18(a) and (b), dated June 10, 2004.

RCIS Quality Control Reviewers Did Not Detect Errors in the Loss Adjustment Process

RCIS quality control reviewers did detect a number of errors loss adjusters made, but they were less successful at correcting more serious procedural errors. For example, one reviewer determined that an adjuster had used incorrect plant prices for an indemnity totaling $3,289,219. This reviewer reduced the indemnity to be paid by $53,200. We found, however, that neither the reviewer nor the adjuster used the correct plant prices, as the indemnity should have been reduced by a total of $100,587. As a second example, reviewers did not identify that loss adjusters were computing losses on plant types that producers had not insured. These errors allowed erroneous payments to be processed and contributed to RCIS misreporting indemnity data to RMA, as discussed in Finding 7.

Ultimately, these problems occurred because RCIS reviewers focused their efforts on checking the accuracy of the loss adjusters' mathematical computations, but did not question more fundamental elements of how producers were insured or how adjusters determined losses.

We also noted that reviewers sometimes contributed to the errors we identified. After one loss adjuster correctly determined before-loss prices for two plants, for example, a reviewer changed the prices for two plant types and used incorrect prices, without any explanation for the changes. This reviewer returned the claim to the adjuster, who did not question the accuracy of the change. Due to this quality control reviewer's error, the producer in question received an overpayment of $14,001.

Under the terms of the SRA, RCIS receives administrative and operating expense subsidies. These funds are intended to help the AIP perform tasks like its quality control review. Since those reviews did not detect serious problems in the underwriting and loss adjustment process, we wanted to alert both RMA and RCIS that RCIS may need to take steps to make its quality control review process more effective. OIG's recommendation in the immediately prior finding addresses some of our concerns. However, RMA may opt to request additional corrective action from RCIS.

Finding 6 RCIS Adjusted Claims Using an Unauthorized Loss Procedure

The three hurricanes that struck Florida nurseries in 2005 spanned CYs 2005 and 2006.[94] At the time Hurricane Wilma struck, many insured plants were still recovering from damage caused by the two prior hurricanes. The value of

[94] Katrina and Rita struck during CY 2005 and Wilma during CY 2006.

those plants, reduced by the amount of prior damage, should have been carried over to Hurricane Wilma claims before determining any further losses.[95] Instead of following RMA policy, however, we found that RCIS implemented an unauthorized procedure for CY 2006 that instructed its adjusters to determine plant values incorrectly for 5 of 12 CY 2006 claims we reviewed. When calculating Wilma claims, adjusters were instructed to use 2006 prices for plants rather than the after-loss 2005 value for plants damaged by Katrina and Rita.[96] Although adjusters had already calculated some indemnities for Hurricane Wilma, the company disseminated the change, trained adjusters to follow it, and required them to recalculate some of the indemnities the AIP had already paid. Due to using this unauthorized procedure, RCIS issued overpayments totaling $409,977 and underpayments totaling $569,969 for 5 of the 17 nursery claims we reviewed.[97]

When AIPs sign the SRA, they agree they will use RMA-authorized contracts, standards, procedures, methods, and instructions when selling and servicing eligible crop insurance contracts.[98] Federal crop insurance regulations state that RMA alone has the authority to set loss adjustment policy, and AIPs cannot deviate from that policy without RMA's written authorization.[99] If AIPs wish to make any change in the loss adjustment process, they must follow a specific and clearly established procedure for requesting the change.[100]

In its nursery crop provisions, RMA established a procedure for adjusting losses caused by multiple hurricanes. Specifically, the provisions require that adjusters carry over, to later loss determinations, the remaining value of plants in recovery from prior hurricanes.[101]

We found, however, that RCIS adjusters did not follow RMA procedures for adjusting damage to plants due to multiple hurricanes and used an unauthorized procedure. Instead of using the remaining CY 2005 values after Katrina and Rita when adjusting Wilma claims, RCIS instructed its adjusters to use CY 2006 prices.

For example, a Canary Island date palm valued at $55.08 was damaged by Hurricane Katrina, and the loss adjuster determined that its after-loss value was $22.03. According to RMA's procedure, this plant's after-loss value of $22.03 should have been used as the before-loss value to calculate damage for the Hurricane Wilma claim. However, due to RCIS' unauthorized procedure, the adjuster was instructed to use the CY 2006 price of $75 for an

[95] 2006 Nursery LASH, §7(H)(3) table group 4, dated November 16, 2005.
[96] RCIS' draft procedure, dated April 7, 2006.
[97] Overpayments and underpayments resulting from the unauthorized procedures are included in exhibit B. Recovery of erroneous payments is recommended in Finding 4.
[98] 2005 SRA, §IV, "General Provisions," F – "Insurance Operations," para. 1(b), dated June 10, 2004.
[99] Title 7, C.F.R., 400.168(d), dated January 1, 2005.
[100] 2006 LAM, part 3, §4, para. 86(B)(1) through (4), dated February 1, 2006.
[101] 06-073 Nursery Crop Provisions, §6(h)(3) revised June 2005.

undamaged Canary Island date palm—and then adjust for the damage from Hurricane Katrina when calculating the additional damage on the nursery appraisal worksheet. This unauthorized procedure increased the value of each Canary Island date palm by $19.92.[102]

We also found that this procedure resulted in underpayments. For example, one nursery suffered losses to its 2-gallon *Nephrolepis exaltata "Bostoniensis"* ferns during Hurricane Rita. The adjuster determined that 223,681 ferns would recover from the Rita damage in 1 ½ months. After the Rita loss, the plants were valued at $1.50 each. One month later Hurricane Wilma struck the nursery, before the damaged ferns had fully recovered. RCIS, using the unauthorized procedure, determined the before-loss value of the ferns to be $.92 while the before-loss value of the ferns computed correctly by RMA procedures would be $1.50. RCIS understated the amount of loss on this claim by $.58 per 2-gallon fern, or $129,735.

Due to this unauthorized change in RMA's policy, RCIS issued overpayments totaling $409,977 and underpayments totaling $569,969, as the following table illustrates, by claim:

CLAIMS	OVERPAYMENT	UNDERPAYMENT
[ ]		$128,084
[ ]	$158,895	
[ ]		$441,885
[ ]	$ 556	
[ ]	$250,526	
Total	**$409,977**	**$569,969**

When we determined that RCIS paid indemnities using a procedure not authorized in the nursery crop provisions or the LASH, we asked RCIS officials why it was being used. They stated that RMA had agreed to the change. However, senior officials at RMA's Kansas City office stated that RMA had not seen a request for a change in procedure, that RCIS did not have the authority to change policy, and that RCIS did not obtain RMA's written approval for changes to the loss adjustment process.

When we informed RCIS that RMA would not confirm that it approved the procedural change, RCIS' Field Compliance Manager and National Claims Manager acknowledged that the Regional Claims Manager did draft this procedure, distribute it, and train adjusters to follow it.

[102] $75 less $55.08 = $19.92.

RCIS officials explained that they had implemented the unauthorized procedure because they believed RMA had approved the change. The issue of how to adjust for damage from successive hurricanes had been the subject of a long-running and unambiguous correspondence between RMA and RCIS. In February 2005—before the 2005 hurricanes—RCIS requested clarification on exactly this issue. RMA's written response was unequivocal: "The insurable value of a partially damaged plant is held constant (at the calculated reduced value) until the recovery period is completed or the plant receives additional damage." In December 2005—after the 2005 hurricanes—RCIS again requested clarification on this point, and again received the same answer. Nevertheless, in April 2006, RCIS ignored RMA's repeated clarifications and issued the unauthorized procedure, requiring its adjusters to recalculate indemnities payments for claims that were affected by multiple hurricanes.

OIG found that RCIS' unauthorized change to the nursery crop provisions affected more than the five claims we identified. We requested that RCIS provide us a list of all nursery claims that were affected by this unauthorized change. However, the AIP could not provide us an accurate list because it did not track, in its information system, claims that were affected by the unauthorized procedure.

In response to our request, RCIS did provide us with information on 66 claims. This list stated that the difference caused by RCIS' unauthorized change in procedure for these 66 claims was $1.8 million in overpayments and $128,084 in underpayments. RCIS' Field Compliance Manager stated that this was the AIP's best attempt to show claims that had been affected by the unauthorized procedure. He stated that the list included claims that were corrected due to internal quality control high-dollar ($100,000 or more) reviews. We question, however, this list's completeness and accuracy since it excluded one of the producers we had determined received an overpayment of $250,526, as well as another producer we determined received an underpayment of $441,885.[103]

Overall, we concluded that by implementing this unauthorized change in nursery crop policy, RCIS breached its contractual obligation to RMA under the SRA.[104] This unauthorized procedure also resulted in at least $409,977 in overpayments and $569,969 in underpayments.

Recommendation 14

Determine the extent of overpayments and underpayments RCIS issued to all nursery producers due to this unauthorized change in policy.

[103] We are not taking exception to the amounts listed on this spreadsheet because it was neither comprehensive nor accurate. Overpayments and underpayments resulting from the unauthorized procedures are included in exhibit B and recovery of erroneous payments is recommended in Finding 4.

[104] 2005 SRA, §II.A(9)(a)(i), dated June 10, 2004: AIPs agree to demonstrate substantial conformity with the requirements of this agreement and the regulations and FCIC procedures which include applicable handbooks, manuals, bulletins, memorandums, or other directives issued by FCIC.

Agency Response

See Recommendation 15.

OIG Position

See Recommendation 15.

Recommendation 15

Recover any overpayments from RCIS and direct RCIS to pay producers any underpayments, based on the exceptions identified in Recommendation 14.

Agency Response

RMA conditionally agreed with Recommendations 14 and 15 pending further analysis and evaluation of this matter. The ERCO instructed RCIS to complete a review to determine and correct any overpayments and underpayments due to the unauthorized use of the cited policy. RCIS has completed its review and provided its results to the ERCO. The ERCO will validate the actions taken by RCIS to assure they are adequate to address the circumstances cited in the above recommendations. RMA expects to complete this action by January 2010. RMA requests management decision for these recommendations.

OIG Position

Although RMA conditionally concurred with Recommendations 14 and 15, we need additional information before we can reach management decision. RMA needs to provide OIG with (1) a copy of the AIP's internal review report that has been completed and submitted to RMA; (2) the results of RMA's review and validation of the results of the AIP's review; and (3) RMA's final determination for all questioned indemnity payments (including copies of the accounts receivable established or RMA's justification for not pursuing the questioned indemnity payments).

Finding 7 RCIS Misreported Nursery Indemnity Data to RMA

After claims have been adjusted, AIPs must report to RMA loss claim data for insurance claims they have processed. Accurate reporting of this data is critical, since RMA uses this data to determine its share of the indemnity payments that it will reimburse to the AIPs. However, we found that RCIS misreported its CY 2006 nursery indemnity payment data to RMA three times. RCIS twice misreported the loss claim data when it reported the data in total, instead of by plant type—a change that was effective for CY 2006 nursery crop policies. This occurred because RCIS had not updated its automated claims system to incorporate changes effective for CY 2006 nursery crop policies. Later, in attempting to correct its errors, RCIS again misreported its loss claims data by including uninsured plant types under insurable plant types to bypass RMA's edit check to limit indemnity payments only to insured plant types. We reviewed 14 of the largest claims rejected by RMA's Data Acceptance System (DAS), totaling $14.7 million, and found that RCIS misreported loss data on 12 of the 14 claims, resulting in $1,071,517 in overpayments for uninsured plant types.[105] These "corrections" by RCIS, in effect, bypassed RMA's edit check, seriously undermining the data integrity of RMA's policy data files.

According to the SRA, AIPs agree to collect, maintain, and submit to RMA data in the prescribed format necessary for the operation of the Federal Crop Insurance Program and certify to the accuracy of that data. Any data AIPs submit must be accurate, detailed, and submitted in accordance with procedures.[106]

As part of the underwriting process, RCIS submits premium data which is processed by DAS. Since the CY 2006 nursery crop program changed from insuring a nursery by practice (either field-grown or container) to insuring by plant type, RCIS' data system was updated to accommodate this program change. RCIS' *claims* processing system, however, had not been updated to accommodate changes to the CY 2006 nursery program when Hurricane Wilma struck Florida just 24 days after the 2006 crop year began. RCIS officials explained that their data-entry employees initially entered the Hurricane Wilma claim data for all plant types under one plant type because their system could

[105] Two of the 12 claims that had uninsured plant types resulted in overpayments of $80,976 and are reported in Finding 4 when we discuss loss adjuster errors for uninsured plant types.
[106] 2005 SRA, §IV, "General provisions," B – "Reports," para. 1, dated June 10, 2004.

not receive data for multiple plant types. In order for RCIS to receive payment for these claims, employees were instructed to combine claim data for all plant types and enter the total under one type.

RMA notified RCIS in January and July 2006 that CY 2006 nursery loss claim data needed to be reviewed because it appeared that not all plant types were being reported. In March 2007, RMA enhanced an existing DAS edit check to compare—by plant type—producer premium records with submitted loss records, and to reject any claims that did not match. RMA provided information that explained the edit changes on a DAS status report that was sent to the AIPs during the same month.

Of the $88.6 million indemnity payments that RCIS had paid to producers at the time of the changes to the DAS edit check, RCIS resubmitted claims that it determined would be affected by the changes. Of the resubmitted claims, DAS detected discrepancies and rejected 109 claims totaling $20.4 million. We selected 14 of the largest claims totaling $14.7 million and found that all 14 were rejected because loss data did not match premium data. We also reviewed policy documents for these 14 claims and confirmed that, for 12 of the claims, RCIS had not written insurance for all of the indemnified plant types.[107]

To receive payments on these loss claims, RCIS employees at its regional sales and service office were responsible for correcting and resubmitting these 109 claims. They found that there were more plant types on the production worksheets that adjusters submitted than there were plant types in the claims processing system. The employees were directed to combine the loss claim data, including uninsured plant types, under insurable plant types so that it could pass DAS' edit check. An RCIS official stated that RCIS did not knowingly circumvent RMA's edit check; he assumed that there was some problem with DAS, and not a policy problem.

We concluded that by misreporting this loss claim data, RCIS received payments for uninsured plants. Also, RCIS compromised the data integrity of RMA's policy data files.

In addition to recovering the $990,541 in overpayments that we identified, RMA should review the other 95 claims rejected by DAS to determine if the loss claim data was misreported due to uninsured plant types or other exceptions and seek recoveries for any overpayments. Furthermore, RMA also needs to determine whether RCIS had properly resubmitted all loss claims affected by the CY 2006 nursery program policy changes and seek recoveries if there are any overpayments.

[107] Two of the policies had insured all plant types indemnified. However, the two claims had been computed using RCIS' unauthorized loss adjustment procedure discussed in Finding 6.

Recommendation 16

Recover $990,541 from RCIS for the overpayments on these additional 10 claims that misreported indemnity data.

Agency Response

RMA conditionally agreed with this recommendation pending its further analysis and evaluation of this matter. * * * RMA expects to complete this action by January 2010. RMA requests management decision for this recommendation.

OIG Position

Although RMA conditionally agreed with this recommendation, OIG needs additional information before we can reach management decision. RMA needs to provide us with its final determination for these indemnities payments and copies of the accounts receivable established or its justification for not pursuing the questioned indemnity payments.

Recommendation 17

Review the other 95 claims rejected by DAS to determine if loss claim data was misreported, and, if so, seek recoveries from RCIS for any issued overpayments for uninsured plant types or other deficiencies.

Agency Response

See Recommendation 18.

OIG Position

See Recommendation 18.

Recommendation 18

Determine whether RCIS properly submitted all loss claims affected by nursery program policy changes. Seek recovery from RCIS of all overpayments identified.

Agency Response

RMA conditionally agreed with Recommendations 17 and 18 pending its further analysis and evaluation of this matter. The ERCO instructed RCIS to complete a review of this matter to determine and correct any overpayments and underpayments due to the above discrepancies. RCIS has completed its review and provided its results to the ERCO. The

ERCO will validate the actions taken by RCIS to assure they are adequate and to address the circumstances cited in the above recommendations. RMA expects to complete this action by January 2010. RMA requests management decision for these recommendations.

OIG Position

Although RMA conditionally agreed with our Recommendations 17 and 18, we need additional information before we can reach management decision. RMA needs to provide OIG with (1) a copy of the AIP's internal review, (2) RMA's analysis of the AIP's review, and (3) RMA's final determinations, including copies of the accounts receivable established for all questioned indemnity payments identified or its justification for not pursuing the questioned indemnity payments.

Scope and Methodology

Our audit covered RMA's oversight of RCIS' administration of loss adjustment determinations made for claims resulting from 2005 Florida Hurricanes Katrina, Rita, and Wilma. Due to the magnitude and seriousness of the problems we found with RCIS' loss adjustment process, we focused on how RCIS underwrote its nursery crop insurance policies. We commenced fieldwork in May 2006 at RMA Headquarters and completed our fieldwork in November 2008.

In order to identify potential internal control weaknesses in the adjustment of nursery claims, we performed an analysis of nursery claims resulting from the 2005 Florida hurricanes.[108] The June 2006 database of 2005 hurricane claims we reviewed consisted of 1,263 nursery claims totaling $130.6 million for CY 2005, and 1,398 nursery claims totaling $116.3 million for CY 2006.

We analyzed the database to identify the AIPs that paid the most indemnities and nurseries that received the largest indemnity payments. We also looked at nurseries that had filed claims for both crop years. From this analysis, we judgmentally selected seven nurseries insured by one AIP. These 7 nurseries were owned by 5 RCIS-insured producers who filed 19 claims and received a total of $66.3 million (27 percent of $246.9 million total indemnities from the June 2006 data) in indemnity payments.

We determined that RCIS had adjusted the 17 nursery claims (and 2 rehabilitation endorsements) selected for review. Further, RCIS was responsible for [ ] percent of the nursery liability in Florida for CYs 2005 and 2006. RCIS sold and serviced [ ] nursery policies in Florida totaling [ ] in liability. As a result of the 2005 hurricanes, RCIS paid indemnities totaling [ ].

Under the contractual obligations of the SRA for participating in the Federal Nursery Crop Insurance Program in CYs 2005 and 2006, RCIS received [ ] in premiums for servicing these Florida policies, as well as [ ] in administrative reimbursement from RMA. For all Federal Crop Insurance Programs, RCIS had an underwriting gain of [ ] in CYs 2005 and 2006.[109]

Fieldwork was performed at the RMA National Office in Washington, D.C.; the RMA Regional Office in Valdosta, Georgia; and RMA's Product Management Division in Kansas City, Missouri. We also performed fieldwork at RCIS Headquarters in Anoka, Minnesota; its regional sales and service office in Winston-Salem, North Carolina; and at its contracted

[108] The three 2005 Florida hurricanes spanned RMA's CYs 2005 and 2006.
[109] 2005 SRA, §I, "Definitions" - "Underwriting Gain", dated June 10, 2004.

insurance sales agent's office in [ ], Florida. Finally, we performed fieldwork at the selected nurseries located in [ ] and [ ] Counties in Florida. [110]

Throughout the audit, we worked extensively with RMA officials to ensure that our claim calculations were correct and that we had correctly understood the agency's policies and procedures.

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

At RMA, we:

- Interviewed RMA's management to assess controls over RCIS' administration of the Nursery Crop Insurance Program.
- Interviewed officials to understand RCIS' contractual obligations for underwriting nursery policies and adjusting claims.
- Consulted with RMA nursery program experts to confirm OIG's claim computations and obtain clarifications of RMA's policy requirements.
- Obtained and reviewed documentation of policy and claim information that RCIS reported to RMA.
- Provided RMA's senior management with ongoing briefings and summaries of work performed.

At RCIS, we:

- Interviewed RCIS' senior management, and the sales and service office staff.
- Obtained and reviewed RCIS' policy and procedures for underwriting nursery crop insurance policies and adjusting related claims.
- Obtained and reviewed RCIS' handbooks to implement its contractual obligations under the SRA.
- Obtained and reviewed RCIS' training materials for the Nursery Crop Insurance Program, including both underwriting and loss adjustment.
- Confirmed that RCIS had developed its own procedures to adjust 2006 claims for damages due to multiple hurricanes.
- Obtained and reviewed loss claim and quality control review files for the 19 claims selected for review.
- Assessed RCIS' controls for processing, approving, and reporting nursery crop insurance policies written and claims paid.

[110] We performed work for an Okeechobee County nursery at the owner's office located in Miami-Dade County.

- Interviewed RCIS loss adjusters and quality control reviewers who processed the 19 claims.
- Determined RCIS' policy and procedures for adjusters to follow when computing indemnity payments.
- Determined RCIS' procedures for quality control reviewers to follow when performing quality control reviews of claims exceeding $100,000.

At the sales agent's office, we:

- Interviewed the agent to understand his role in underwriting the policies he sold, as well as the errors in those policies.
- Obtained and reviewed RCIS' policy underwriting files for 19 claims selected for review.

At the producers selected for review, we:

- Interviewed producers, owners, and staff to obtain an understanding of policies they purchased and the claims they filed.
- Obtained and reviewed producers' records available to support the PIVR and claim worksheet.
- Attempted to roll forward two producers' plant inventories from their last physical inventory to the day before Hurricanes Katrina, Rita, and Wilma.

At two producers' CPA firms, we:

- Obtained and reviewed documentation for financial statements and taxes.
- Discussed the CPAs' methodology for performing tests on producers' plant inventories, as well as their role in the physical inventory necessary to opine on the financial statements.

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	DESCRIPTION	AMOUNT	CATEGORY
1	Indemnities, Premiums, and Administrative and Operating Expenses Paid to RCIS	[ ]	Questioned Costs, Recovery Recommended
2 *	Ineligible Nursery	$ 5,727,137	Questioned Costs, Recovery Recommended
4 *	Loss Adjustment Overpayments	$ 9,417,235 [111]	Questioned Costs, Recovery Recommended
4 *	Loss Adjustment Underpayments	$ 466,221	Questioned Costs, Underpayments
7 *	Uninsured Plant Indemnity Payments	$ 990,541	Questioned Costs, Recovery Recommended

*** See footnote [112]**

[111] To avoid double counting of the payment errors, we deleted from the total dollars in adjuster errors in exhibit B the adjuster errors for claim nos., 15 and 19, since we already questioned the nursery's eligibility for insurance and recommended recovery of the full indemnity payments in Recommendation 8. That is, $10,644,328 - $1,166,648 – 60,445 = $9,417,235.

[112] These amounts are included in the [ ] questioned costs and should be followed up only if RMA determines to retain its reinsurance on all of RCIS' nursery policies in Florida and not seek recovery of the full amount cited in Recommendation 3. Erroneous payments identified during this review totaled $16,601,134.

Exhibit B – *Loss Adjusters' Errors by Claim*

CLAIM NO.	PRODUCER	CROP YEAR	INDEMNITY PAID	CORRECT INDEMNITY	OVER-PAYMENT	UNDER-PAYMENT	ADJUSTER ERRORS
1	A	2005	$13,452,033	$ 9,723,909	$ 3,728,124	$ 0	a, b, c, d, j, k, n, o, p, t
2	A	2005	2,006,376	1,494,261	512,115	0	a, b, c, d, e, g, j, k, n, o, p, t
3	A	2005	2,198,197	1,096,126	1,102,071	0	a, b, c, d, k, n, o, p, t
4	B	2005	618,829	618,829	0	0	a, c, n, o, p, t
5	C	2005	1,622,081	1,350,370	271,711	0	a, c, d, j, n, o, p, t
6	D	2005	1,025,446	1,025,330	116	0	a, c, d, j, n, o, p, t
7	E	2005	9,312,857	9,267,110	45,747	0	a, c, d, l, n, o, p, t
8	A	2006	8,924,321	9,388,310	0	466,221	a, c, d, e, g, j, k, n, p, q, s, t
9	A	2006	2,738,561	2,738,561	0	0	a, c, d, n, o, p, s, t
10	A	2006	3,249,477	854,443	2,395,034	0	a, c, d, e, f, k, j, n, o, p, r, t
11	B	2006	3,236,019	3,188,632	47,387	0	a, c, d, f, n, o, p, t
12	C	2006	1,421,798	915,583	506,215	0	a, c, e, h, j, n, o, p, q, t
13	D	2006	815,330	784,732	30,598	0	a, c, e, j, n, o, p, q, t
14	B	2006	1,491,847	1,417,104	74,743	0	a, c, f, j, n, o, p, t
15	E	2006	5,461,294	4,294,646	1,166,648	0	a, c, d, f, n, o, p, r, t
16	E	2006	7,364,463	7,162,631	201,832	0	a, c, d, f, i, n, o, p, q, r, t
17	E	2006	620,977	123,573	497,404	0	a, c, d, f, n, o, p, q, t
18	E	2006	494,780	490,642	4,138	0	f, m, t
19	E	2006	265,843	205,398	60,445	0	f, m, t
TOTAL			**$66,320,529**	**$56,140,190**	**$10,644,328**[113]	**$466,221**	

[113] This total represents the total dollar errors that we found in our review of the loss adjustment process for all 19 claims.

a—Adjuster failed to document how he arrived at loss determinations.
b—Adjuster failed to exclude invalid third peak endorsements.
c—Adjuster accepted producers' post-hurricane plant counts to compute before-loss values.
d—Adjuster failed to confirm producers' plant counts and damage assessments.
e—Adjuster failed to verify significant increases in inventory values between Katrina and Wilma.
f—Adjuster computed indemnities for uninsured plant types.
g—Adjuster failed to properly determine values for plants with prior damage.
h—Adjuster indemnified a producer's price endorsement at prices higher than the sales records support.
i—Adjuster overstated damage to the plants the producer soon sold at full value.
j—Adjuster used incorrect prices when calculating indemnities.
k—Adjuster failed to classify plant varieties correctly when calculating indemnities.
l—Adjuster paid an indemnity for an uninsurable cause of loss.
m—Adjuster failed to verify expenses claimed under the rehabilitation endorsement.
n—Adjuster failed to consult with plant specialists for determining the extent of damage to plants and the recovery time needed.
o—Adjuster failed to provide producers with written consent to dispose of dead plants.
p—Adjusters failed to verify that PIVR was supported with farming records.
q—Adjusters used unauthorized loss procedures to compute indemnity payments.
r—Adjusters applied peak endorsements to plants for which producers did not select peak insurance coverage.
s—Adjuster computed two losses using the same Boston ferns for a producer.
t—RCIS' quality control review did not detect or identify adjustment errors identified by OIG.
u—Quality control reviewer made an error after adjuster had computed correctly.

USDA

United States Department of Agriculture

Risk Management Agency

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

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

JAN 1 4 2009

FROM: Michael Hand
Audit Liaison Official

SUBJECT: Office of Inspector General Audit 05099-28-At, Revised Official Draft Report 2005 Emergency Hurricane Relief Efforts

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

RECOMMENDATION NO. 1:

Seek an opinion from the Office of the General Counsel (OGC) as to whether RMA can suspend RCIS from writing any new business or renewing any existing business in the Federal crop insurance program until the conditions in this report are corrected.

RMA Response:

We concur with this recommendation and obtained an opinion from OGC on the issue identified in this recommendation. OGC has opined that [redacted]

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 2:

Deny reinsurance for [redacted] in liability underwritten by RCIS for CYs 2005 and 2006 Florida nursery policies.

RECOMMENDATION NO. 3:

Recover the Governments share of the [redacted] in indemnities that RCIS paid out on these policies, [redacted] in premium subsidies, and [redacted] in administrative and operating subsidies.

RMA

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

An Equal Opportunity Employer

RECOMMENDATION NO. 4:

Recalculate the effect on the underwriting gains for both crop years. Also assess additional penalties to the maximum extent allowed under the SRA.

RMA Response:

We do not concur with recommendation numbers 2, 3, and 4. In the exit conference for this audit, a senior member of your staff explained the report contained two sets of monetary recommendations and that an OGC opinion would determine which set would be appropriate for RMA to implement. Because OGC has opined that [redacted] For this reason, RMA has initiated actions to implement the other monetary recommendations contained within this report.

RMA requests management decision for these recommendations.

RECOMMENDATION NO. 5:

Designate an oversight representative to monitor RCIS' activities, including needed corrective actions discussed in this report, until it complies with the terms of the SRA.

RMA Response:

We concur with this recommendation. The RMA, Reinsurance Services Division (RSD) has an Account Executive (AE) assigned to each approved insurance provider (AIP), and established processes and procedures to address and correct SRA violations. In accordance with established RSD written processes and procedures, whenever an SRA violation is detected and the need for corrective action has been determined by RMA, a corrective action plan is developed by RSD and the AE oversees the implementation of corrective action until the AIP fully complies with the terms of the SRA.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 6:

Direct RCIS to annually sample producers participating in the nursery crop insurance program and request support for the producers' PIVRs.

RMA Response:

We concur with this recommendation. RMA has issued Manager's Bulletin MGR-08-003 and MGR-08-003.1 directing all AIPs to perform the tasks contained in this recommendation.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 7:

Direct RCIS to retain pre-acceptance inspection reports for all nursery producers actively insured in each crop year.

RMA Response:

We concur with this recommendation. Based on the existing regulations (specifically the definition of "Policy" in the Basic Provisions of Insurance), pre-acceptance inspections would be a part of the "accepted application" and required to be retained with the policy from year to year until the policy is cancelled. Based on the audit findings it is clear that some in the crop insurance industry failed to recognize this requirement. To that end RMA will change the Nursery Underwriting Guide to clarify the requirement and ensure all AIPs retain the inspection reports with the application while the policy is active and without regard to the 3-year retention requirement of the SRA. RMA will implement the change to the Underwriting Guide not later than January 2010.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 8:

Recover $5,727,137 in indemnity payments paid by RCIS to the nursery that was not eligible for insurance coverage.

RMA Response:

We conditionally agree with this recommendation pending further analysis and evaluation of this matter. The RMA, Eastern Regional Compliance Office (ERCO) has opened a case and will complete a review of the above matter. If the ERCO determines there is a monetary discrepancy due to erroneous determinations, RMA will cite RCIS, establish an accounts receivable and collect any monies owed from RCIS.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 9:

Validate that RCIS has implemented an underwriting process that meets the requirements of the Federal Crop Insurance Program. Additionally, documents and report to OIG any changes to the RCIS underwriting process since OIG's review.

RMA Response:

We concur with this recommendation. Since OIG's review, RMA conducted a review of RCIS's underwriting processes and found they are sufficient to meet the requirements of the Federal Crop Insurance Program. A briefing outlining the findings and results of this review was

provided to your staff. The information and documentation from the review was presented to the auditors, and questions or concerns were addressed over a three day period of time.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 10:

Initiate a review to determine if this agent's actions were willful and, if they were, debar this agent from participating in the Federal Crop Insurance Program.

RMA Response:

We conditionally agree with this recommendation pending further analysis and evaluation of this matter. Within the next year, the ERCO will opened a case and complete a review of the actions by the above agent. The results of this review will be utilized by RMA to determine appropriate future actions.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 11:

Recover $9,417,235 in loss adjustment overpayments from RCIS and direct RCIS to pay producers underpayments totaling $466,221.

RMA Response:

We conditionally agree with this recommendation pending further analysis and evaluation of this matter. The ERCO has opened a case and will complete a review of the above matter. If the ERCO determines there is a monetary discrepancy due to erroneous determinations, RMA will cite RCIS, establish an accounts receivable and collect any monies owed from RCIS.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 12:

Direct RCIS to develop and implement a comprehensive set of SOPs for the loss adjustment process. Those SOPs should include guidance for handling the errors identified in this report, including verifying that producers are eligible to claim losses. Distribute these SOPs to loss adjuster working for the company, and incorporate them into the company's annual training curriculum.

RMA Response:

We concur with this recommendation. In response to the OIG audit report, RMA directed and RCIS provided a comprehensive set of SOPs regarding its nursery loss adjustment process. RCIS contends that these SOPs are more rigorous than those in effect for the eligible crop

insurance contracts that were subject to the OIG review and fully comply with current RMA procedures. However, the sufficiency of these procedures and their incorporation into training materials will be determined through RMA's independent investigation. If RMA determines that RCIS's procedures are inadequate or if the SOPs are not properly incorporated into training, RCIS will be directed to take appropriate corrective action. RMA expects to complete this action by January 2010.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 13:

Direct RCIS to develop a disaster contingency plan for handling large-scale disasters.

RMA Response:

We concur with this recommendation. In response to the OIG draft audit report, RCIS provided RMA with a description of its procedures for handling large-scale disasters, including such contingencies that would require the activation of "travel teams." Consequently, RCIS has complied with this recommendation.

RMA requests management decision for this recommendation.

RECOMMENDATION NO. 14:

Determine the extent of overpayments and underpayments RCIS issued to all nursery producers due to this unauthorized change in policy.

RECOMMENDATION NO. 15:

Recover overpayments from RCIS and direct RCIS to pay producers any underpayments, based on the exceptions identified in Recommendation number 14.

RMA Response:

We conditionally agree with these recommendations pending further analysis and evaluation of this matter. The ERCO instructed RCIS to complete a review of this matter to determine and correct any overpayments and underpayments due to the unauthorized use of the cited policy. RCIS has completed their review and provided their results to the ERCO. The ERCO will validate the actions taken by RCIS to assure they are adequate to address the circumstances cited in the above recommendations. RMA expects to complete this action by January 2010.

RMA requests management decision for these recommendations.

RECOMMENDATION NO. 16:

Recover $990,541 from RCIS for the overpayments on these additional 10 claims that misreported indemnity data.

RECOMMENDATION NO. 17:

Review the other 95 claims rejected by DAS to determine if loss claim data was misreported, and, if so, seek recoveries from RCIS for any issued overpayments for uninsured plant types or other deficiencies.

RECOMMENDATION NO. 18:

Determine whether RCIS properly submitted all loss claims affected by nursery program policy changes. Seek recovery from RCIS of all overpayments identified.

RMA Response:

We conditionally agree with these recommendations pending further analysis and evaluation of this matter. The ERCO instructed RCIS to complete a review of this matter to determine and correct any overpayments and underpayments due to the above discrepancies. RCIS has completed their review and provided their results to the ERCO. The ERCO will validate the actions taken by RCIS to assure they are adequate to address the circumstances cited in the above recommendations. RMA expects to complete this action by January 2010.

RMA requests management decision for these recommendations.

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