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Report to the Honorable Charles W. Stenholm, Ranking Minority Member, Committee on Agriculture, House of Representatives

September 1999

CROP INSURANCE

USDA Needs a Better Estimate of Improper Payments to Strengthen Controls Over Claims

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Resources, Community, and
Economic Development Division

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The Honorable Charles W. Stenholm
Ranking Minority Member
Committee on Agriculture
House of Representatives

Dear Mr. Stenholm:

Federal crop insurance protects participating farmers against crop losses caused by perils such as droughts, floods, hurricanes, and other natural disasters. This multibillion-dollar program, administered by the U.S. Department of Agriculture's Risk Management Agency (RMA), provides subsidized insurance through private insurance companies that assume a portion of the risk associated with claims payments. Since 1981, when the current crop insurance program was established, the program has provided $14.1 billion to farmers for insured crop losses. The program's loss experience is a major factor in determining the cost of federal crop insurance to farmers and to the government.

Concerned about RMA's effectiveness in managing the process to minimize erroneous claims payments, you asked us to (1) review the extent to which crop insurance claims are paid in error—either unintentionally or fraudulently—and, to the extent practical, compare the rate at which claims are paid in error with rates for other types of insurance; (2) examine the insurance companies' and RMA's quality controls to ensure that accurate claims payments are made; and (3) describe the proposals being considered to reduce insurance companies' administrative requirements and the potential impact of these proposals on the operations of the crop insurance program.

Results in Brief

There are no precise estimates of the extent to which crop insurance claims are paid in error. While the Risk Management Agency estimated that about 5 percent of claims were paid in error in 1997, the agency's methodology for estimating errors was questionable in several respects. Specifically, the estimate was based on an inadequate sample size and did not include the results of timely, on-site reviews to detect errors resulting from fraud. Although information on payment errors for other types of property and casualty insurance is limited, a recent insurance industry study reported higher rates of fraud-related payment errors than the Risk Management Agency reports for crop insurance. We are making a

recommendation to the Secretary of Agriculture to improve the agency's methodology for estimating the program's error rate for claims payments.

The Risk Management Agency and the insurance companies revised the process for examining the accuracy of paid claims in 1998. Previously, the agency had reviewed the claims of a few companies every year for accuracy, but available resources limited the number of claims that could be examined. Under the new process, the agency is able to get much broader coverage of claims activity by relying on the companies themselves to review an agency-selected statistical sample of their claims to detect erroneous payments. The companies use agency guidance for ensuring that the sampled claims were properly paid. The agency then reviews a sample of these same claims to determine whether the companies' review processes are adequate. While it is too early to evaluate the effectiveness of this approach, success will depend heavily on how well the companies implement this approach and the quality of the Risk Management Agency's oversight of the process.

The Risk Management Agency and the companies are considering proposals to simplify administrative requirements in three principal areas: developing alternatives to producers' actual production histories, which are used to determine the insured value of a crop; simplifying the administration of one type of crop insurance—catastrophic; and changing other administrative requirements, such as allowing farmers to self-certify claims below certain dollar amounts. The agency and the companies do not agree on how these simplification proposals would affect program operations. For example, while some simplification proposals could reduce the companies' administrative costs, these proposals could also increase claims payments, which would increase government costs.

Background

Although the federal crop insurance program was established in 1938, it was substantially changed and expanded by the Federal Crop Insurance Act of 1980. Currently, RMA—through the Federal Crop Insurance Corporation (FCIC)—relies on private companies to sell and service crop insurance policies under their own name and to adjust losses when a claim is made. Federal crop insurance is currently available for 75 crops on a county-by-county basis. In addition, the number of farmers participating in the program has increased to over 400,000 out of about 2 million farmers nationwide.

The financial soundness of the crop insurance program depends on substantial participation by the nation's farmers. Premium rates and cost to the government are determined largely by the program's loss experience. Generally, the higher the crop losses, the higher the premiums in future years. From 1981 through 1998, FCIC paid farmers $14.1 billion for insured crop losses, and in 1998 alone, FCIC paid $1.7 billion.

Federal crop insurance offers farmers two primary levels of coverage, catastrophic and buyup, which are available for major crops. Catastrophic insurance, created by the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, was designed to provide producers with a minimum level of protection for a small processing fee. Buyup insurance protects against more typical and smaller crop losses in exchange for a farmer-paid premium. In addition to these two primary types of coverage, federal crop insurance offers a number of products that protect farmers' revenues against declining market prices for their production.

Federal crop insurance is sold to farmers by insurance agents representing one or more insurance companies that have a standard reinsurance agreement with the U.S. Department of Agriculture (USDA) to sell and service crop insurance. The agent and the farmer work together to determine the level of coverage for expected yield and/or price and the number of acres to be planted. A farmer's expected yield is based on 4 to 10 years of production history. In the absence of at least 4 years of production history, the county's averages for each crop can be used. The agent and the farmer sign a completed application attesting that the information is correct prior to transmitting the application to the insurance company.

Upon receiving the application, the insurance company (1) verifies the information by comparing it with any prior records, (2) recalculates the computations on the applications, (3) determines if the completed application meets all RMA requirements, and (4) calculates the premium. If the application meets all company and RMA requirements, the company issues the policy to the farmer.

If farmers incur crop losses, they file a claim with their insurance agent or company. The company assigns an adjuster who visits the farm and, using RMA guidance, determines the percentage of loss of the acres planted. The adjuster forwards the claim to the insurance company, which verifies and recalculates the claim. If all company and RMA requirements are met, the

company pays the claim to the farmer. All paid claims are subject to review by the companies and various government agencies, including RMA, USDA's Office of the Inspector General (OIG), and GAO.

The Federal Managers Financial Integrity Act (FMFIA), and the Federal Financial Management Improvement Act (FFMIA), hold agency managers responsible for ensuring that adequate systems of internal controls have been developed and implemented. An adequate system of internal controls should provide reasonable assurance that an agency is effectively and efficiently using resources, preventing unauthorized disposition of agency assets, and producing reliable financial reports. Furthermore, the Government Performance and Results Act (Results Act) encourages federal agencies to more effectively use their resources by requiring annual reporting on the extent to which agencies meet their annual performance goals.

In the last 5 years, the OIG has reported that the insurance companies' quality control reviews were superficial and did not provide an independent verification that claims were properly paid.[1] To strengthen the quality control process, the Inspector General recommended that RMA develop an estimate of claims paid in error, including a detailed definition of what constitutes an error. In 1998, in response to a series of internal reviews and to the requirements of the Results Act, RMA initiated a study to estimate the number of claims paid in error. This estimate is discussed in the following section.

Extent to Which Crop Insurance Claims Are Paid in Error Is Uncertain

The extent to which crop insurance claims are paid in error has never been precisely calculated. USDA reported in its 1998 financial statements that an estimated 5 percent of crop insurance claims were paid in error in 1997. However, this estimate may not be accurate because RMA's methodology for estimating errors is questionable in several respects. Information on error rates for other types of insurance that could be used to compare with the RMA estimate is limited.

RMA's Estimate of Errors Is Questionable

RMA's estimate of errors may not be accurate because it is based on a small sample and did not include the results of timely field work to detect fraud.

[1]Report To The Secretary On Federal Crop Insurance Reform, USDA Office of the Inspector General, Audit Report No. 05801-2-At (April 1999); Risk Management Agency—Reinsured Companies' Actual Production History Self-Reviews, USDA Office of the Inspector General, Audit Report No. 05099-1-Te (Sept. 1997); and Risk Management Agency—Federal Crop Insurance Claims, USDA Office of the Inspector General, Audit Report No. 05601-3-Te (Feb. 1998).

In order to determine a rate of claims paid in error, RMA used a statistical sample of 200 claims—out of more than 121,000 claims paid in 1997. However, because the sample size was relatively small, the estimated error rate could be inaccurate by as much as 80 percent. Therefore, RMA's 5-percent estimate could be as low as 1 percent or as high as 9 percent. Because of the small sample size and the fact that only part of a claim may have been paid in error, these error rates cannot be used to estimate the percentage of dollars paid in error. However, according to GAO and OIG reports completed in 1987 through 1991, incorrect payments totaled about 9 percent or more of the total dollar value of claims paid in the samples reviewed. The GAO report, based on a sample of claims payments for three crops in five states, did not contain a national estimate of payment errors. The OIG report, based on a nationwide sample of claims payments, recognized limitations in the accuracy of its estimate because of the small number of claims reviewed.

According to RMA and OIG officials, a larger sample size would have generated a more accurate error rate to serve as a baseline for judging future performance. These officials said that a minimum sample size of between 500 and 800 claims would be needed to produce an accurate error rate.[2] However, RMA officials told us they did not have the resources to review a larger sample size.

RMA estimated that one-tenth of 1 percent of the claims paid in 1997 were fraudulent. To arrive at this estimate, RMA reviewed the paperwork associated with claims to uncover fraudulent statements about the amount of acreage planted, production history, or crop produced. However, RMA's Deputy Administrator for Compliance told us that this type of review is not always effective in identifying fraud and that a more timely and thorough field evaluation is needed to develop accurate estimates of fraud. More specifically, claims would have to be examined when they are adjusted. In this way, a reviewer could review the condition of crops for which losses are claimed and interview individuals who might have knowledge about the farmer's production, such as elevator operators or field office officials in USDA's Farm Service Agency. This kind of inspection is common for other types of insurance claims. For example, the Federal Emergency Management Agency checks for fraud by quickly inspecting flood sites for damage after insurance company inspections and before issuing claims payments.

[2]A larger sample size will also provide a basis to estimate the dollar value of claims paid in error.

Even with a timely, thorough field visit, identifying rates for fraudulent claims payments is very difficult, according to RMA's Deputy Administrator for Compliance, because it is hard to determine whether an individual has purposefully misrepresented claims data.

Information on Error Rates for Other Lines of Insurance Is Limited

We could not obtain information on overall (unintentional and fraudulent) payment error rates for other types of private insurance because companies consider such data proprietary. However, other federal insurance programs periodically measure payments made in error. For example, the Department of Health and Human Services (HHS) made such an estimate for improper Medicare benefit payments to providers in 1998. While the Medicare payments made in error are not directly comparable to crop insurance payments made in error, improper Medicare payments were about 7 percent of the $177 billion paid to health care providers, according to HHS estimates.

Although information on overall error rates for other types of insurance was limited, we identified a recent industry study of payment errors associated specifically with fraud. According to this study, the fraud rate for property and casualty insurance—the type of insurance most comparable to crop insurance—was estimated to be between 10 and 25 percent in 1996.[3] The study's estimates were based on surveys of fraud prevention associations and insurance companies.

RMA Is Relying on Companies' Quality Control Efforts to Reduce Erroneous Payments

Under a recently instituted process to minimize the number of erroneous payments, RMA relies principally on the insurance companies' reviews of an RMA-selected statistical sample of claims payments. This process is also designed to ensure broader coverage of claims reviews by having all the companies review a portion of their claims payments each year. To prevent and detect erroneous claims, RMA has also instituted procedures that increase training requirements for agents and loss adjusters.

RMA's New Process for Reviewing Claims Depends on the Accuracy of the Companies' Efforts

Until 1998, RMA conducted its own annual reviews of claims payments to assess companies' handling of claims, including error detection. However, because of limited resources, RMA did not review enough claims or insurance companies to adequately determine if claims were properly paid. Instead, these reviews focused on a sample of claims from 3 to 4 of the 18 companies that sell and service crop insurance. In addition, RMA relied on referrals from farmers, insurance companies, and USDA's Farm

[3]Insurance Fraud: The Quiet Catastrophe 1996, Conning Insurance Research and Publications.

Service Agency to identify erroneous payments. A number of the insurance companies told us that they supplemented RMA's reviews by internally reviewing the accuracy of a portion of the claims' payments they made each year.

Starting in 1998, RMA and the insurance companies agreed to change the way claims are reviewed for erroneous payments. This new process provides a basis for the companies to determine if their internal controls are working effectively and if their employees, including agents and adjusters, are properly trained in order to minimize erroneous claims payments. RMA's role is to oversee the companies' efforts to review claims payments for errors. To implement the new process, RMA provided the companies with guidance on the type and scope of reviews to be conducted. It also provided each company with a statistical sample of at least 50 (and in many cases up to 150) of its policies that had claims paid for crop year 1998. RMA's compliance staff provided oversight by reviewing about 600 selected claims from the same sample. The random samples were designed to cover a percentage of crop insurance policies written and crop insurance claims paid for each company.

Under RMA's new review process, for each policy in the sample, the company must verify the accuracy of the information reported by the policyholder, the agent, and the loss adjuster, including the planted acreage reported for the policy, the certification of the producer's actual production history, and the summary of insurance coverage. In addition, each company is required to review all relevant claim information and supporting production information, such as the production worksheets, appraisal reports, and settlement sheets. RMA completes the review process by selecting a sample of the companies' reviews and auditing them for quality and completeness. To implement these new review requirements, several participating companies instituted new procedures and hired and trained additional staff.

In 1998, the first year of implementing the new review process, RMA and the companies worked together to clarify technical and reporting requirements and placed less emphasis on completing all the steps in the review process. For example, RMA reviewed procedural matters with companies and clarified supporting documentation requirements for future submissions rather than evaluating the effectiveness of the companies' reviews.

In addition to the new review process, RMA has established a working group with the participating crop insurance companies to review and revise compliance processes as needed. This working group hopes to find ways RMA and the companies can cooperate to better use limited compliance resources and to reduce the number of erroneous payments.

Revised Training Requirements for Agents and Adjusters

In order to reduce the potential for erroneous claims payments, RMA requires the companies to provide a minimum number of hours of training per year for their agents and loss adjusters. In 1998, to improve the skills and knowledge of agents and adjusters, RMA revised these requirements. For new agents, annual training requirements increased from 8 hours to 12 hours. For experienced agents, these training requirements decreased from 6 hours to 3 hours. For new loss adjusters, annual training increased from 32 classroom hours and 24 field training hours to a total of 60 hours, of which 24 must be in the classroom. For experienced loss adjusters, training requirements increased from 16 hours to 18 hours. Also, by 2000, all agents and adjusters will be required to pass certain competency tests in order to continue to sell and service crop insurance policies. Among other things, an agent must be able to review actuarial documents, know how to complete and distribute forms and materials used in sales and service activities, and understand reporting requirements and other procedures and regulations.

Consensus Lacking on the Effects of Additional Simplification Proposals on Program's Operations

In response to the Federal Crop Insurance Reform and the Department of Agriculture Reorganization Act of 1994, RMA and the industry are considering proposals in three areas to reduce administrative effort and cost: (1) changing the way producers' actual production histories are determined, (2) simplifying the administration of catastrophic insurance, and (3) increasing the amount of allowable overstatement of acreage and production on claims forms—referred to as the allowable tolerance for erroneous claims payments.[4] However, RMA and the companies do not agree on the savings associated with these changes and their potential effect on the program's vulnerability to losses.

[4]The proposals we refer to were submitted by a working group of the National Crop Insurance Services—an industry association representing the majority of the companies participating in the federal crop insurance program.

Changing the Way Actual Production History Is Calculated

Currently, a crop insurance policy's insured value and associated risk is based primarily on the producer's actual production history for 10 years. Developing this history is time-consuming and somewhat complex because it is based on a rolling 10-year crop production average, and a farmer often cannot adequately document production.

Questions are frequently raised by farmers and their associations about the number of crop years required for determining this history, the reliability of the farmer-provided information, and the reliability and fairness of the formula used.[5] In addition, some farmers have raised questions about the validity of using a 10-year average crop production history because recent technical improvements in herbicides, pesticides, and other farming practices have allowed farmers to greatly increase production in the past few years. To deal with these questions, insurance companies have proposed two alternative approaches that the industry is now considering. These proposals, if adopted, would probably be pilot-tested in a number of locations for each crop before they are instituted nationwide.

One industry proposal would replace farmers' individual production history with an average county yield for all farmers in that county. By adopting this approach, the insurance companies and the farmers could eliminate extensive documentation and calculations and make it easier for the companies to compute losses. However, farmers with above-average production are generally opposed to this change because it would benefit farmers with lower than average historical yields and penalize farmers with higher historical yields. Such a change could discourage farmers with above-average production from participating and encourage greater participation from farmers with below-average production. The change could benefit the federal government by reducing the possibility of fraud associated with false or inaccurate production data, but it could increase claims payments to producers with below-average production.

The second industry proposal would eliminate the use of production history and average county yield altogether. Instead, the proposal would rely heavily on the combined judgment of the farmer and insurance agent to establish expected production and value of coverage, and on the

[5]In addition, USDA's OIG has consistently reported problems associated with calculating and applying production history data for determining claims. Risk Management Agency—Crop Insurance Claims in Virginia 1995 and 1996 Crop Years, Audit Report No. 05601-1-Hy (Dec. 1997); Risk Management Agency—Reinsured Companies' Actual Production History Self-Reviews Washington, D.C.; USDA Office of the Inspector General, Audit Report No. 0599-1-Te (Sept. 1997); and Risk Management Agency—Crop Insurance Claims in California 1995 and 1996 Crop Years, USDA Office of the Inspector General, Audit Report No. 05601-1-SF (May 1997).

integrity of the loss adjuster to calculate the amount of loss. It is therefore a more subjective approach and could expose the government to greater risk. In addition, this alternative could eliminate the need to collect actual production data, making it difficult to return to the current method for determining insurable value and loss.

Changes in the way the production histories are calculated could be costly to insurance companies because of the need to create new software programs and revise thousands of individual histories. According to some insurance company officials, these revisions could undermine their companies' investments in databases.

Simplifying Catastrophic Insurance Coverage

This industry proposal would simplify catastrophic insurance in three ways. First, it would eliminate coverage for different acreages (fields), which is now allowed when a farmer has different ownership-operator agreements (shares) within a county. This proposal would require farmers to buy a farmwide policy by crop, regardless of ownership arrangements, and could reduce the companies' administrative costs for selling and servicing catastrophic crop insurance. Insuring on a farmwide basis by crop would reduce the opportunity for farmers to create or enhance claims by shifting reported production from one insured field to another. (According to agency officials, some producers shift reported production from one insured field to another in order to understate production on one acreage, resulting in a fraudulent claim for that field.) This practice is difficult to discover and document. However, according to farmers and their associations, requiring them to buy farmwide policies would reduce participation in the program because this change could reduce their coverage. For example, assume a farmer insured two 100-acre fields with actual production histories of 80 bushels of corn per acre. Under a farmwide policy, the farmer would not receive a claims payment if one field produced 40 bushels per acre and the other produced 120 bushels per acre since the average farmwide production would be 80 bushels per acre, which is equal to the farmer's actual production history. Under a field-by-field policy, the farmer could receive a claims payment on the field that produced 40 bushels per acre because its yield was below the actual production history.

The two remaining administrative simplification ideas under this proposal include easing reporting requirements on production history and allowing farmers to self-certify claims. For example, several companies said that allowing farmers to report acreage by telephone and to self-certify claims

below certain dollar limits could simplify their administrative processing of claims. However, according to an RMA official, acreage reporting by telephone could create legal problems if the farmer disputed the unsigned acreage report. In addition, self-certification of claims could increase the number and amount of fraudulent claims. Since this proposal was first made, RMA has permitted self-certification of claims on a trial basis.

Changing Tolerances

Other industry proposals to reduce administrative costs are under consideration by RMA and the industry. One proposal, increasing the tolerances for acreage reporting and claims dollars paid, could affect the program's financial soundness.

Currently, insurance companies are required to seek reimbursement for overpayments from farmers who incorrectly reported planted acres if the overpayment exceeds $250. The proposed change would not require reimbursement for an error less than $500. This change responds to crop insurance companies' concerns that it costs more than $250 to collect small overpayments.

This proposal to increase tolerances could increase the amount of claims filed and indemnities paid, according to an RMA official, once farmers become aware of the higher tolerance. This could adversely affect the soundness of the crop insurance program. However, it could also reduce administrative costs and provide faster claims service. The costs and savings associated with this proposed change have not been estimated.

Conclusions

Recent changes to RMA's program for ensuring the accuracy of claims payments appear to offer a good opportunity to maximize the limited resources available to both the crop insurance companies and RMA. However, until RMA has sound information on the level of improper claims payments, it cannot evaluate, among other things, the effectiveness of the new quality control program or the impact of these changes on the program effectiveness. Such information is fundamental for basic program management and proper control over the millions of federal dollars spent each year for claims payments.

Recommendation

We recommend that the Secretary of Agriculture require the Administrator of the Risk Management Agency to evaluate the costs of alternative methods for developing more accurate estimates of error rates for claims

payments and implement an alternative that would improve the estimate at a reasonable cost to the federal government. Alternatives that could be considered include (1) having the Risk Management Agency sample and analyze a sufficient number of claims to make an estimate and (2) using the claims sampling done by the insurance companies under the quality control program to make the estimate.

Agency Comments

We provided copies of a draft of this report to USDA's Risk Management Agency for review and comment. We met with officials from the Risk Management Agency, including the Agency Administrator. USDA generally agreed with the information provided in our report and the report's conclusions and recommendation. The agency provided a number of technical changes and clarifications to the report, which we incorporated as appropriate.

Scope and Methodology

To determine the extent to which crop insurance claims are paid in error and compare this rate with the experience of other types of insurance, we reviewed agency documentation and discussed with RMA and insurance company officials their efforts to determine error rates. We also contacted a number of insurance companies to determine how federal crop insurance claims paid in error compare with other types of insurance, such as property and casualty. Furthermore, we discussed with program officials other federal programs, including Medicare and federal flood insurance, which periodically measure their claims paid in error.

To review RMA's internal controls over claims payments for crop losses, we reviewed agency documentation and discussed with agency and insurance company officials their efforts to improve their quality control programs. We also discussed with USDA's OIG its recommendations for improving USDA's efforts in reducing crop insurance claims paid in error. Furthermore, we reviewed a series of OIG reports dating from 1983 that have commented on the extent to which crop insurance claims have been paid in error and on the weaknesses in federal and insurance companies' controls over claims payments for crop losses.

To identify opportunities to reduce administrative requirements that may contribute to erroneous claim payments and/or increase costs for the insurance companies, we contacted National Crop Insurance Services, Inc., an industry association for crop insurance companies; several participating crop insurance companies; RMA; several private insurance

agents and farmers representing different regions of the country; and associations representing major commodities insured by federal crop insurance. We discussed with these officials how a proposed change might affect program simplicity, savings, and soundness. To identify changes already made, we contacted RMA officials to obtain a summary of simplification actions completed.

We performed our review from January 1999 through September 1999 in accordance with generally accepted government auditing standards. Although we did not independently assess the accuracy and reliability of USDA's computerized databases, we used the same files USDA uses to manage the crop insurance program, which are the only available data.

We are sending copies of this report to Senator Richard Lugar, Chairman, and Senator Tom Harkin, Ranking Minority Member, Senate Committee on Agriculture, Nutrition, and Forestry; Representative Larry Combest, Chairman, House Committee on Agriculture; and other appropriate congressional committees. We are also sending copies to the Honorable Dan Glickman, the Secretary of Agriculture; the Honorable Kenneth Ackerman, Administrator, the Risk Management Agency; and the Honorable Jacob Lew, Director, Office of Management and Budget; and other interested parties. Copies will also be made available to others upon request.

Please contact me at (202) 512-5138 if you or your staff have any questions about this report. Key contributors to this report were Ronald E. Maxon, Jr.; Sheldon H. Wood, Jr.; Robert G. Hammons; Jay Scott; David A. Rogers; and Carol Herrnstadt Shulman.

Sincerely yours,

Robert E. Robertson
Associate Director, Food
and Agriculture Issues

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