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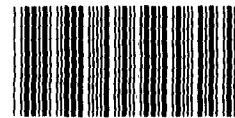
Testimony

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Results of GAO's Review of the  
Department of Agriculture's  
Federal Crop Insurance Program

Statement of  
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Development

Before the  
Subcommittee on Conservation, Credit, and  
Rural Development  
Committee on Agriculture  
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

We are here today at your request to present the findings of our review of the Federal Crop Insurance Corporation's (FCIC) crop loss adjustment activities. This work, Mr. Chairman, was done in response to your concerns that FCIC was not accurately adjusting losses claimed on crop insurance policies in accordance with governing policies and procedures. As requested, our work focused on the loss adjustment activities of private, reinsured companies since they, not FCIC, are responsible for adjusting losses on all of the policies they sell and because reinsured companies now have most of the crop insurance business. For comparison purposes, we also reviewed FCIC's own loss adjustment activities on policies sold by master marketers.

The remainder of my testimony will discuss the results of our review and some actions that we believe FCIC needs to take to help get loss adjustment activities under control. We expect to issue our detailed report on this review in June.

#### SUMMARY OF FINDINGS

In short, Mr. Chairman, we found that FCIC is simply not properly managing the loss adjustment process being carried out by reinsured companies. FCIC's oversight and control over these companies is inadequate at best, resulting in millions of dollars being spent on claims which should not have been paid. While there are also problems with claims adjusted by FCIC, they pale in comparison to the problems we found with claims adjusted by reinsured companies.

Briefly, for claims adjusted by reinsured companies, we found that

- 95 percent of the claims in our sample were not adjusted in accordance with FCIC policies and procedures,
- 31 percent of the \$9.4 million in claims should not have been paid, and
- for many claims, the types of problems which resulted in overpayments were so obvious that they appeared to be intentional. So far, we have referred 14 of these cases to the Department's Office of Inspector General (OIG) for investigation.

For claims adjusted by FCIC, we found that, while 62 percent of the claims adjusted were not fully in accordance with policies and procedures, the overpayments amounted to only about 1 percent of claims paid.

I think it is important to highlight that our findings are based on a sample of loss claims in 5 states.<sup>1</sup> Nonetheless, because we found such consistent and widespread problems in every location we visited, we believe that our findings are indicative of a systemic nationwide problem and that FCIC management needs to take more aggressive and expeditious action to get the loss adjustment activities of reinsured companies under control. The accuracy of loss adjustments by reinsured companies are fundamental to a successful crop insurance program because they have a direct relationship to FCIC's ability to establish an actuarially sound insurance program.

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<sup>1</sup>These states are California, Louisiana, Mississippi, Montana, and Oklahoma.

It is also important to note that we could not have done this review without the cooperation of FCIC management, who provided FCIC quality control personnel to assist us in our review. Further, while FCIC has begun to improve its oversight and control over the loss adjustment practices of reinsured companies, in part because of the concerns expressed by this subcommittee and the information revealed by our review, much more needs to be done.

Before providing you with the details of our findings and additional actions that we believe FCIC should take, let me briefly describe the basics of the loss adjustment process and the scope of our work.

#### BACKGROUND

Since the enactment of the Federal Crop Insurance Act of 1980 (P.L. 96-365), which requires an expanded and actuarially sound program, FCIC has gone from an insurance delivery system that relied primarily on FCIC employees to sell and service crop insurance policies to one that relies primarily on private companies. The private companies fall into two categories--reinsured companies and master marketers.

In 1986, reinsured companies accounted for about 80 percent of all crop insurance sales. From 1982 through 1986 indemnities (claims) paid on policies sold by reinsured companies accounted for about \$1.5 billion, or about one-half of all indemnities paid under the crop insurance program. In addition to selling the policies, reinsured companies perform all loss adjustment activities on the policies they sell.

Under FCIC's master marketer program private companies are used to sell FCIC policies and to do some servicing of the policies. However, unlike the reinsurance arrangement, FCIC loss adjustment contractors perform the loss adjustment functions on all policies sold by master marketers.

The loss adjustment process for both reinsured companies and FCIC is basically the same, consisting of four major elements. For each policyholder, a determination needs to be made regarding (1) whether the claimant is and has remained eligible to participate in the program, (2) the amount of crop production a policyholder is insured for (guaranteed production), (3) the amount of production actually experienced by the policyholder (actual production), and (4) the amount of the insurance payment due to the policyholder. The determination of these four elements is the responsibility of the sales agents and loss adjusters.

Our work was based on a review of 171 loss claims in 5 states and covered claims from crop years 1984 and 1985 on 3 crops (wheat, soybeans, and grapes). One hundred and thirty-four claims were adjusted by reinsured companies and 37 by FCIC. Essentially, our sampling plan was to select a number of the larger claims in each of the five states. We sampled fewer FCIC claims because our review was to focus on the activities of reinsured companies.

The details of our sample selections are in Appendix I of my statement. We reviewed the loss adjustment practices used on each claim with the assistance of quality control reviewers provided to us by FCIC. The adjusters provided to us were, according to FCIC

officials, some of the best loss adjusters in the Corporation. To the extent that proper practices were not followed we determined the cost of any errors. In each case, the FCIC quality control reviewers concurred with our findings. When our work was completed, we presented the details of our findings on each claim to the 12 reinsured companies and 4 FCIC field offices involved in our review to obtain their comments. In addition, we briefed the manager of FCIC on our findings.

REINSURED COMPANIES' LOSS

ADJUSTMENT PRACTICES ARE

COSTING THE GOVERNMENT MILLIONS

We found that 127 of the 134 claims adjusted by reinsured companies were not adjusted properly--an error rate of about 95 percent. For the 134 claims we found 269 errors, an average of about 2 errors per claim. Appendix II to my statement shows the results of our review by state and crop.

While a small number of incorrect claims resulted in underpayments involving relatively small amounts, 63 percent of the incorrect claims resulted in overpayments of \$10,000 or more. In total, we found that reinsured companies paid out \$9.4 million in claims that should only have totaled \$6.5 million, about 31 percent less. In other words, for every \$3 of claims paid only about \$2 should have been paid.

We found problems in each of the four loss adjustment elements: 54 percent of the 269 errors in the cases we reviewed occurred because of incorrect determinations of production guarantees, 36 percent because of incorrect determinations of

actual production, 7 percent due to incorrect determinations of payment amounts, and 3 percent due to incorrect determinations of program eligibility. Appendix III to my statement shows the number of errors by category of problem. I will briefly discuss each of these elements and cite some examples of the kinds of problems we and the FCIC experts assisting us found in these four elements.

#### Problems with guaranteed production determinations

Insuring a producer for an amount of guaranteed production basically means that a policyholder will be insured for crop production up to certain prescribed amounts. For example, a wheat producer guaranteed production of 40 bushels per acre on a 100 acre farm would get an insurance payment if actual production was less than 4,000 bushels (40 bushels x 100 acres).

We and the FCIC personnel assisting us found several different types of loss adjustment problems in this area. Although some of the problems we found would require a long explanation of detailed procedures, one clear example that demonstrates the kinds of problems that occur involves a case of overstated acreage. In this case, we found that a soybean producer was insured for a guaranteed amount of production on 897 acres of land. However, in reviewing the available records and discussing the claim with the producer, we found that only 637 acres of soybeans were actually planted. As a result, this producer could not have realized the amount of guaranteed production he was insured for under any circumstances. Accordingly, he was incorrectly paid \$30,142 for acreage he did not plant. In this case neither the reinsured company's sales agent nor the loss adjuster verified the number of acres actually planted

as required by FCIC procedures. In commenting on this case, the reinsured company said that it disagreed with our finding that the acreage was overstated but offered no support or basis for disputing the evidence we and the FCIC personnel obtained from the records and the producer. Thus, we continue to believe that the claim was overpaid by \$30,142.

Overall, of the 269 errors identified we found 144 that impacted the determination of production guarantees.

#### Problems with actual production determinations

Determining a producer's actual production on all insured acreage was the second most common problem area in adjusting losses. Such a determination is critical to the loss adjustment process because the reinsured company needs to know the actual amount of production on insured land to determine whether a loss claim is justified and, if so, for how much. Overall, we and the FCIC personnel assisting us found 98 errors impacting on the determinations of actual production. As with guaranteed production, we found several different kinds of problems in this area. Again, however, I will cite a simple example to illustrate the kinds of problems that occur.

This case involves a producer of wine grapes who was paid for a claim of \$110,655 based on reported production of 15,910 boxes of grapes and guaranteed production of 40,005 boxes of grapes. However, based on our review of the available production records and discussions with the producer, we found that the actual production for this producer exceeded 42,000 boxes of grapes. Accordingly, because the actual production exceeded the guaranteed



production, the entire payment of \$110,655 should not have been made.

Although the loss adjuster that handled the claim expressed surprise that we had found a large amount of unreported production, he agreed with our finding. Also, an official of the reinsured company agreed with our finding but said that the producer had purposely underreported production and therefore the adjuster was not at fault. We believe, however, that the adjuster did not adequately follow FCIC's procedures. Under FCIC's procedures an adjuster is to take extra steps to verify production when there is reason to believe that the producer has not reported all production. In this case, the adjuster's file showed that he personally had observed some harvesting on September 16, 1985. The producer's report of sales, however, showed a production cut-off date of September 14. Thus, the adjuster knew or should have known that all production had not been reported.

Problems in determining the amount  
of payment due to an insured producer

This element of the loss adjustment process simply involves determining the amount of payment or indemnity due to an insured producer. We found 19 instances where the determination of the amount of indemnity due a producer was not done properly. The specific kinds of problems we and FCIC personnel found in this area varied, but all of them are distinct from any of the problems we found in other areas of the loss adjustment process.

One case illustrating an incorrect determination of indemnity involves a soybean producer who insured his crop based on his

having a 100 percent insured interest. He subsequently experienced an insurable loss on his crop production and submitted a loss claim to his insurance company. He was paid an indemnity of \$117,229 based on a 100-percent interest in the crop. However, we found that the producer had certified to the Department's Agricultural Stabilization and Conservation Service's (ASCS) county office that he only had a 70-percent interest in the crop. As a result, he should only have claimed and been paid 70-percent of what was actually paid or \$82,061. In this case, the producer was overpaid by about \$35,000. According to FCIC procedures, the adjuster is supposed to verify an insured's interest in the crop, but in this case no verification was made. The reinsured company agreed with our findings on this claim.

#### Problems with program eligibility determinations

The fourth area of the loss adjustment process involves determining producer eligibility for obtaining crop insurance. We found the fewest problems in this area, with only eight instances of eligibility problems. However, the problems we did find were significant. While we again found a variety of types of problems, a case example will serve to demonstrate the kinds of problems I am talking about.

In this case, a wheat grower did not submit an acreage report to the insurance company by the designated filing date, which was June 30, 1985. The acreage report and insurance application makes up the insurance contract. The filing deadline is to help assure that crops have not already been damaged at the effective date of the insurance contract.

While FCIC policy allows for the acceptance of late filed acreage reports, it is only permitted after the crop is examined by a company representative and a determination is made that a normal crop can be expected. In this particular case, the required acreage report was filed on July 19, 1985--19 days after the filing deadline. In reviewing the reinsured company's file, we found that company adjusters had visited the farm prior to July 19<sup>th</sup> based on the producer's notification of a potential loss and made a yield appraisal on four of the eight units comprising the farm. The adjusters' reports showed that a substantial loss could be expected on the four units.

Despite the adjusters' findings, the reinsured company accepted the late filed acreage report and thus insured a known loss on the four units. Also, the company did not determine whether a normal crop could be expected on the remaining four units as is required by FCIC policy. In addition to the \$68,713 claim for the loss on wheat, the producer also received payment for a claim on barley grown on the same eight units amounting to \$563,780. The late filed acreage report also applied to the barley crop.

In responding to our findings, an official of the reinsured company told us that the producer did not submit the acreage report by the filing deadline because certain information from the ASCS county office that was needed to prepare the report was not available prior to the June 30 deadline. The information the reinsured company official cited, however, is not needed to prepare an acreage report. Thus, we believe that the \$68,713 claim for

wheat and \$563,780 claim for barley was not in accordance with FCIC's policies and procedures.

FCIC HAS DONE BETTER  
THAN REINSURED COMPANIES  
IN ADJUSTING CLAIMS

To compare the adjustment activities of FCIC and the reinsured companies, we reviewed 37 claims on policies sold by master marketers. These claims are adjusted by FCIC. The claims we reviewed represented total payments of \$1.7 million and were for the same crops in the same 5 states as those claims we reviewed for reinsured companies. Although we found that a large number of the claims adjusted by FCIC were not adjusted in accordance with applicable policies and procedures, the dollar amounts involved were relatively small.

Of the 37 claims that we reviewed, 23, or about 62 percent, were not adjusted in accordance with FCIC procedures. Total overpayments amounted to about \$26,000 and total underpayments to about \$6,000. Thus, there was a net overpayment of \$20,000 on the \$1.7 million paid out on the 37 claims--an overpayment rate of only about 1 percent compared with an overpayment rate of about 31 percent for the claims adjusted by the reinsured companies. Appendix IV to my statement shows the results of our review by state and crop.

Although there is room for improvement in FCIC's own loss adjustment activities, relatively speaking, it did a much better job than the reinsured companies in assuring claims were reasonably accurate. For the 37 claims reviewed we found 33 instances where

correct procedures were not followed, an average of less than 1 problem per claim compared with an average of 2 problems per claim for the reinsured companies. Further, not only were the number of errors less for the claims adjusted by FCIC, but most of the errors we found were not as serious or as blatant as those for the reinsured company adjusted claims. The errors in the FCIC adjusted claims were generally more procedural or administrative in nature.

FCIC HAS MADE SOME IMPROVEMENT

BUT MUCH REMAINS TO BE DONE

Since shortly after the enactment of the 1980 act, FCIC has focused much of its attention on increasing the role of reinsured companies in the crop insurance program, to the extent that reinsured companies are now responsible for about 80 percent of all crop insurance sales. Unfortunately, FCIC did not give much attention to establishing the requisite control and oversight mechanisms to help assure that the reinsured companies' loss adjustment activities were working properly.

Only recently, has FCIC taken a first step towards gaining some oversight and control over the loss adjustment activities of reinsured companies. This step involved establishing an organizational unit to systematically review the loss adjustment activities of reinsured companies. This unit--called the compliance division--is now in the process of becoming fully operational.

To help assure the unit's effectiveness and to effectively oversee and control the loss adjustment activities of reinsured companies, much more needs to be done. Specifically, FCIC needs to

- systematically review the content and implementation of the reinsured companies' loss adjustment quality control programs, and

- establish better internal controls over claims payment data received from the reinsured companies by verifying the information submitted in support of claims.

In addition, FCIC needs to help assure the effectiveness of the compliance division by establishing a systematic process for determining

- when and what administrative actions should be taken against reinsured companies based on the results of compliance reviews, and

- whether overpayments identified by compliance reviews are repaid to the government.

Until August 1986, when the new compliance division was established, FCIC had no systematic way of monitoring the loss adjustment activities of the reinsured companies. FCIC made some reviews of loss claims on a sporadic basis primarily as a result of whistle-blower complaints. The new compliance division has also concentrated on these whistle-blower type cases. At the present time, the division has about 30 people, including support staff. It is authorized 40.

Although the compliance division is only about 9 months old, the results of the work to date, like our own results, have shown that reinsured companies are not adequately implementing FCIC's loss adjustment policies and procedures. FCIC has taken some actions based on compliance work but it has been ad hoc. For example, FCIC has referred some cases to the Department's Inspector General for criminal investigation. In addition, FCIC suspended the operations of one company for a 3-week period. However, there have been other cases where compliance reviews have revealed significant problems where FCIC has taken no action or has been very slow to act. For example, in a number of cases compliance reviews have identified overpayments on specific claims and problems with the loss adjustment processes of specific companies. But, FCIC management has taken no action to systematically (1) assure that the overpayments were repaid or (2) improve the loss adjustment practices being used by the companies involved.

FCIC needs to develop a consistent and systematic approach in dealing with problems identified by the compliance division by establishing criteria for determining when to take administrative action against a company and what actions to take. FCIC also needs to develop a tracking system to determine whether overpayments identified by its compliance group, OIG, or us, have been repaid. Under the Standard Reinsurance Agreement, FCIC can collect overpayments from the reinsured companies with interest. As it is, FCIC does not have such a system and could not tell us whether identified overpayments have been repaid or how much has been repaid.

Further, FCIC has required reinsured companies to establish quality control systems to help assure the accuracy of the claims adjustment process. These systems are to be reviewed and approved by FCIC. Our analysis of the systems used by the 12 reinsured companies included in our review, however, showed that the quality of review by the companies was inconsistent.

Officials of all 12 companies told us that their companies perform a desk audit of all claims before payment to ensure that all forms are properly completed, computations are correct, and claims are adequately supported by production and appraisal worksheets. Where the systems differed among the companies was in the area of supervisory reviews of the adjusters' work. Several of the companies' systems called for checking all claims over a certain dollar amount, some for random spot checks, and some did not provide for any supervisory reviews.

In contrast, FCIC has a structured and consistent process of reviewing the work of its loss adjusters. The level of review work depends on (1) whether the adjuster is certified by FCIC or not and (2) the adjuster's performance. Basically, the more errors an adjuster makes the more rigorous is FCIC's review. If a certified adjuster makes two procedural errors on two consecutive claims, the individual is decertified by FCIC and his or her wage rate is reduced. This obviously provides a significant incentive to the adjusters to perform at a high level of competence.

Although compliance reviews have covered some aspects of reinsured companies quality controls systems the compliance division has not yet made a comprehensive review of a company's



system. Further, because FCIC does not require the reinsured companies to make supervisory reviews of agents' and loss adjusters' work, the compliance division would not report the lack of any supervisory review system as a problem.

Another important area in need of attention by FCIC is its internal controls over the indemnity data reported by the reinsured companies. In September 1986 we reported that FCIC does not verify loss information submitted by the companies.<sup>2</sup> As a result, FCIC has no assurance that the information reported by the companies is accurate. This is critical because FCIC uses this data for making payments to the reinsured companies, setting premium rates, and for making management decisions relating to actuarial matters.

During our review of the claims handled by reinsured companies we found examples where the lack of verification of this kind of data may have resulted in substantial overpayments. Drought on an irrigated farm is not an insurable loss under FCIC's procedures, however, in reviewing the 134 claims, we found some instances where this policy was not followed. Because of this, we analyzed computer tapes for all claim payments made to reinsured companies nationwide for crop years 1984 through 1986 to determine the extent of this problem. We found that \$17.5 million in claims were paid for drought losses on irrigated farms. Some of these claims may have been incorrectly classified as to cause of loss or irrigated practice. FCIC's accounting system for claims on its own policies is designed to reject such claims but the system used to pay the

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<sup>2</sup>Federal Crop Insurance Corporation's Financial Statements for 1985 and 1984 (GAO/AFMD-86-58, Sept. 19, 1986).

reinsured companies is not. We brought this to the attention of FCIC management in November 1986 so that they could follow-up on the problem and take corrective action. However, so far, FCIC has taken no corrective action.

Mr. Chairman, in light of the severe and widespread nature of the problems FCIC faces in this case, I do not believe FCIC can or should wait for the formalization of our recommendations on what needs to be done.

We believe the evidence we have presented is quite persuasive and that FCIC should act now to

- systematically review the content and implementation of the reinsured companies' loss adjustment quality control programs,
- establish better internal controls over claims payment data received from the reinsured companies by verifying the information submitted in support of claims,
- establish a systematic process for determining when and what administrative actions should be taken against reinsured companies based on the results of compliance reviews, and
- establish a systematic process for determining whether overpayments identified by compliance reviews are repaid to the government.

I want to note that our final report in June will probably identify additional actions FCIC should take to increase the effectiveness of its oversight and control over the loss adjustment practices of the reinsured companies.

Further, we believe that the severity and scope of the problems call for a reexamination of this issue again next year. By that time, FCIC should have ample time to act on the problems we have identified.

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That concludes my statement. I will be happy to answer any questions.

DETAILS OF SAMPLE SELECTION

To determine whether reinsured companies were adjusting claims for losses in accordance with procedures and methods consistent with those used by FCIC, we initiated our review in Mississippi with a sample of crop year 1984 claims, the most recent data available when we began our work in June 1986. We then expanded our scope to include a sample of crop year 1985 claims in California, Louisiana, Montana, and Oklahoma. The four additional states were selected based on geographic dispersion, type of crop, and relatively large amounts of total claims paid.

For the five states, we judgmentally selected 134 claims over \$20,000, selecting claims from contiguous counties within each state to minimize the logistical problems to gather necessary information, particularly production data, to evaluate the accuracy of the adjusted claims.

Of the 134 claims reviewed we selected 84 soybean and 25 wheat claims because these crops, respectively, accounted for 55 and 20 percent of total FCIC indemnities paid during the period 1981-85. We selected 25 grape/raisin claims in California because these crops represented about 65 percent of total indemnities paid in the state in 1985.

Thirty-seven master marketer claims were also judgmentally selected for review. They represented the highest dollar value claims in the same counties and crops where we selected reinsured company claims. We selected two claims per county except in Mississippi where only one per county was reviewed. The master marketer claims represent 22 percent of the total claims reviewed which is approximately the same ratio to the number of reinsured company claims in 1985--four to one.

RESULTS OF REVIEW OF CLAIMS ADJUSTED BY REINSURED COMPANIES

State and crop	Total claims reviewed		Claims overpaid		Claims underpaid	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
California Grapes and raisins	25	\$1,359,616	18	\$640,558	6	\$19,483
Louisiana Soybeans	26	2,161,134	20	464,790	5	\$7,711
Mississippi Soybeans	38	1,384,022	37	933,589	1	317
Montana Wheat	25	3,310,719	19	250,560	3	4,478
Oklahoma Soybeans	<u>20</u>	<u>1,195,369</u>	<u>19</u>	<u>646,048</u>	<u>0</u>	<u>0</u>
Total	<u>134</u>	<u>\$9,410,860</u>	<u>113</u>	<u>\$2,935,545</u>	<u>14</u>	<u>31,989</u>
Percent of total claims reviewed	100	100	84 <sup>a</sup>	31 <sup>b</sup>	10 <sup>a</sup>	0.3 <sup>c</sup>

<sup>a</sup>Combined error rate is 95 percent (84.3% plus 10.4%).

<sup>b</sup>Percent of overpayment based on corrected net amount (actual payment adjusted for overpayments and underpayments) of \$6,507,304 is 45 percent.

<sup>c</sup>Percent of underpayment based on corrected net amount of \$6,507,304 is 0.5 percent.

Source: GAO schedule.

FREQUENCY OF PROBLEMS FOUND REGARDING  
DETERMINATION OF PRODUCTION GUARANTEE,  
ACTUAL PRODUCTION, INDEMNITY, AND ELIGIBILITY

<u>Loss adjustment element</u>	<u>Reinsured Companies</u>		<u>FCIC</u>	
	<u>Number of problems</u>	<u>Percent of total</u>	<u>Number of problems</u>	<u>Percent of total</u>
Determination of:				
Guaranteed production	144	54	14	42
Actual production	98	36	19	58
Indemnity due	19	7	0	0
Eligibility	<u>8</u>	<u>3</u>	<u>0</u>	<u>0</u>
Total	<u>269</u>	<u>100</u>	<u>33</u>	<u>100</u>

RESULTS OF REVIEW OF CLAIMS ADJUSTED BY FCIC

<u>State and crop</u>	<u>Total claims reviewed</u>		<u>Claims overpaid</u>		<u>Claims underpaid</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
California Grapes and raisins	6	\$34,672	0	\$ 0	2	\$5,264
Louisiana Soybeans	9	217,768	7	5,603	1	410
Mississippi Soybeans	8	392,298	4	4,159	1	213
Montana Wheat	8	1,023,904	4	12,838	2	374
Oklahoma Soybeans	<u>6</u>	<u>57,217</u>	<u>2</u>	<u>3,107</u>	<u>0</u>	<u>0</u>
Total	<u>37</u>	<u>\$1,725,859</u>	<u>17</u>	<u>\$25,617</u>	<u>6</u>	<u>\$6,261</u>
Percent of total claims reviewed	100	100	46 <sup>a</sup>	1.5 <sup>b</sup>	16 <sup>a</sup>	0.4 <sup>c</sup>

<sup>a</sup>Combined error rate is 62 percent (46% plus 16%).

<sup>b</sup>Percent of overpayment is 1.0 percent.

<sup>c</sup>Percent of underpayment is 0.4 percent.

Source: GAO schedule.