United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Conservation, Credit and Rural Development, Committee on Agriculture, House of Representatives

November 1989

CROP INSURANCE

Private Company Loss Adjustment Improving, but Overpayments Still High

GAO/RCED-90-32

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-209866

November 7, 1989

The Honorable Glenn English
Chairman, Subcommittee on Conservation,
Credit and Rural Development
Committee on Agriculture
House of Representatives

Dear Mr. Chairman:

In response to your request, we have examined the loss adjustment activities of private companies reinsured by the Federal Crop Insurance Corporation (FCIC). Your concerns over loss adjustment were prompted by our April 1987 testimony and subsequent report, which concluded that overpayment of claims by private companies was costing the government millions of dollars. This report examines the extent to which loss adjustment problems still exist.

We are sending copies of this report to appropriate House and Senate committees and subcommittees; interested members of Congress; the Secretary of Agriculture; the Manager of FCIC; the Director, Office of Management and Budget; and other interested parties.

Major contributors to this report are listed in appendix III. If you have any questions or need additional information, I can be reached at (202) 275-5138.

Sincerely yours,

John W. Harman
Director, Food and
Agriculture Issues

of a statistical sample of 1987 crop insurance claims, that about 16 percent of all payments made for claims of $20,000 or greater were overpayments. This is about half the overpayment rate found in GAO's judgmentally selected sample of 1984-85 claims.

While it is difficult to pinpoint the reasons for the apparent improvements, GAO believes that expanded FCIC oversight played a significant role in encouraging the reinsured industry to increase the quality of loss adjustment activities. Not all of FCIC's expanded oversight activities were in place in time to affect the 1987 sample of claims GAO reviewed. Consequently, their impact on loss adjustment overpayment rates will not be seen on claims before 1988. Despite apparent improvements that have occurred or could occur, FCIC oversight and control over the reinsured industry can be strengthened.

GAO's Analysis

Loss Adjustment Has Improved but Overpayments Still Appear to Be High

With the assistance of FCIC loss adjusters, GAO reviewed a statistical sample of 101 1987 crop insurance claims and compared national estimates calculated from this sample with the results of its earlier review of 134 1984-85 judgmentally selected claims. While it is difficult to attribute all changes between the two samples strictly to changes in performance, GAO believes that loss adjustment practices have improved since its earlier review. More specifically, GAO estimates that 16 percent of all payments made for 1987 claims of $20,000 or greater were overpayments, which is just over half of the 31-percent overpayment rate for the 1984-85 claim sample. Despite this improvement, GAO estimates that nationwide 1987 overpayments for all claims of $20,000 or more are still substantial—about $17 million.

In both reviews, the most frequent sources of errors were associated with determining a farmer's (1) actual production during the year of the claimed loss and (2) production guarantee. Actual production is used to calculate the extent of a farmer's loss. It is deducted from the production guarantee—the amount of crop production for which the farmer is insured—to arrive at the insured's loss.

these criteria to identify and penalize companies that do not perform at acceptable levels. Currently, FCIC plans to implement its system of standards and penalties in July 1990. GAO has recommended the development of such standards in the past and continues to believe that they are an essential part of an effective oversight program.

Recommendations

GAO believes that the estimated loss adjustment overpayment rate is still high but is encouraged by the apparent improvements seen since its earlier review. FCIC management should not, however, diminish any of its efforts aimed at strengthening its oversight functions and ensuring that the millions of federal dollars spent in the crop insurance program are adequately protected. GAO is already on record recommending that FCIC develop and implement a system of performance standards and sanctions in an expeditious manner. Accordingly, we are not making any recommendations in this report.

Agency Comments

FCIC generally agreed with the report conclusions concerning the efforts and progress made in its oversight activities. Additionally, it agreed with the need to continue strengthening oversight activities in order to lower overpayment rates. It cautioned, however, that the report's statistical estimates, which are based on claims of $20,000 or more, may be questionable if perceived as indicative of all claims. GAO acknowledges that the report's statistical estimates apply only to 1987 claims of $20,000 or more. Such claims represent over one third of the total dollar claim payments made for the year. GAO believes that discussions of the report's estimates are carefully qualified to avoid any confusion on the matter.

Abbreviations

ASCS	Agriculture Stabilization and Conservation Service
CCC	Commodity Credit Corporation
FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
OIG	Office of Inspector General
pps	probability proportional to size
USDA	U.S. Department of Agriculture

- provide a program of reinsurance (whereby part or all of the risk is transferred from the original insurer to another party), to the maximum extent practicable, to begin not later than with the 1982 crops.

Program Delivery

Prior to the 1980 act, FCIC sold and serviced crop insurance policies using its own employees, employees of USDA's Agriculture Stabilization and Conservation Service (ASCS),[2] and a small number of independent agents. FCIC employees adjusted all claims for losses. In implementing the expanded insurance program under the 1980 act, FCIC believed that heavy reliance on the private sector would be necessary to reach a high level of participation in the program. Moreover, the shift to the private sector was viewed as being in accordance with the congressional intent of the act.

Accordingly, FCIC developed an Agency Sales and Service Agreement and a Standard Reinsurance Agreement. Under the former agreement, an insurance company or agency (commonly referred to as a master marketer) agrees to sell and service FCIC insurance policies. FCIC compensates the master marketers for their services on a commission basis—currently 20 percent of premiums for all policies sold. Under this delivery system, FCIC maintains responsibility for adjusting all losses on the policies sold by master marketers. Also, under the master marketer arrangement, FCIC is responsible for all losses on policies sold by master marketers and realizes all gains.

The reinsured delivery system is implemented through a Standard Reinsurance Agreement between FCIC and private companies and agents. Under this system, private insurance companies sell, service, and adjust losses on policies they sell under their own names. The reinsured companies are also compensated for administrative, operating, and claim adjustment expenses—currently 34 percent of the companies' total premiums. In addition, FCIC reimburses reinsured companies for a portion of any state premium taxes paid. Further, unlike the master marketer delivery system, FCIC and the reinsured companies share in the gains and losses experienced on policies written under this arrangement. However, as reinsurer, FCIC is responsible for paying most of the losses and receives most of the gains.

[2]ASCS is the USDA agency responsible for administering commodity assistance programs.

How the Loss Adjustment Process Works

The loss adjustment process basically compares the amount of production an insured farmer actually experiences with the amount of production guaranteed by the crop insurance policy. For example, assume that a farmer with an average production of 100 bushels of corn per acre selects a 65-percent production guarantee option and a $2.70 per bushel payment level. If a natural disaster occurs and the actual production drops to 20 bushels per acre, the farmer would have an insured loss of 45 bushels (65 percent of 100 bushels less the 20 bushels actually produced). FCIC would pay the farmer $121.50 ($2.70 x 45 bushels) for each acre insured.

According to FCIC procedures, the loss adjustment process can be divided into four major elements. The four elements involve determining (1) program eligibility—whether a person is eligible to get crop insurance, (2) the amount of production that is guaranteed under each policy—called the production guarantee, (3) the amount of actual production, and (4) the amount of indemnity due. Each selling agent has prime responsibility for determining eligibility and establishing the production guarantee. The loss adjuster has prime responsibility for determining actual production and the indemnity due on each claim. In addition, the adjuster is responsible for verifying that the program eligibility and production guarantee determinations are correct. Each of the four elements involved in adjusting a claim is described below.

Determining Eligibility

In determining whether a producer applying for crop insurance is eligible, the sales agent must establish that the acreage to be insured is classified as insurable by FCIC; the insured has an insurable interest in the crop as landlord, owner-operator, or tenant; and the crop is planted by the final plant date allowed by the policy. Further, prior to a prescribed deadline for the particular crop being insured, the producer must submit an FCIC acreage report that sets forth such information as the location and number of acres to be planted, the insurance coverage desired, and other related information.

Determining Production Guarantee

The sales agents must consider three major issues in determining a producer's production guarantee: the number of acres insured, the farming practice used, and the land's productive capacity as determined by FCIC. The agent should verify that the number of acres specified on a producer's insurance application is accurate by either actual measurement

Determining Indemnity

When the adjuster determines that the amount of actual production is less than the amount of production guaranteed by the policy, due to an insurable cause of loss, the indemnity must be determined. This is basically done by multiplying the difference between the actual production and the amount of the production guaranteed by the price option selected by the producer at the time the insurance policy is purchased. However, if the insured has less than a 100-percent interest in the crop, the indemnity is reduced to reflect the percentage of the insured's interest.

Past Criticism of Reinsured Company Loss Adjustment Practices

Since 1987, we and USDA's Office of Inspector General (OIG) have been highly critical of FCIC's control over the loss adjustment practices of reinsured companies. These criticisms created considerable congressional concern about FCIC's management of the program. In April 1987 testimony before the Subcommittee on Conservation, Credit and Rural Development, House Committee on Agriculture and in a subsequent November 1987 report, we concluded that poor loss adjustment practices by reinsured companies were costing the government millions of dollars in overpaid claims. More specifically, we examined 134 1984-85 claims adjusted by reinsured companies in 5 states and found that 95 percent had been adjusted incorrectly. Of the $9.4 million in claims that we examined, $3 million, or 31 percent, had been overpaid. In contrast, we examined master marketer claims that had been adjusted by FCIC employees and found overpayments of only about $19,000, or 1.1 percent, of the $1.7 million dollars of claim payments that we reviewed. We reported that, in our opinion, the problems we identified with the loss adjustment practices of reinsured companies were so consistent and frequent that they appeared to be indicative of a nationwide problem.

The problems with reinsured company loss adjustment practices were due, in part, to weak FCIC management. Specifically, we found that FCIC had exercised little oversight over the activities of reinsured companies. Further, FCIC neither verified loss information that the companies submitted nor accurately screened claims for obvious errors prior to payment.

As a result of our findings, we made a number of recommendations to the Secretary of Agriculture to improve the effectiveness of FCIC and reinsured company operations. Our recommendations dealt with FCIC attaining increased and more effective oversight and control of reinsured company operations and upgrading the operational requirements for reinsured companies. They included (1) improving FCIC's process for

Table 1.1: Characteristics of 1984-85 Claim Sample and 1987 Claim Sample

1984-85				1987			
State/No. of claims		**Crop/No. of claims**		**State/No. of claims**		**Crop/No. of claims**	
California	25	Grapes & raisins	25	Arkansas	26	Wheat	1
						Soybeans	25
Louisiana	26	Soybeans	26	Georgia	35	Peanuts	29
						Cotton	2
						Tobacco	1
						Tomatoes	3
Mississippi	38	Soybeans	38	Illinois	8	Soybeans	5
						Corn	3
Montana	25	Wheat	25	Mississippi	32	Soybeans	28
						Cotton	2
						Wheat	2
Oklahoma	20	Soybeans	20				
Total	**134**		**134**		**101**	**101**	

A significant difference between the two samples is that the earlier sample was selected judgmentally and, as a result, we could not estimate the national impact of our findings. However, for this report we used a statistical technique that allowed us to estimate the national implications of our findings. Consequently, when comparing the results of our past report with this report, it is important to recognize the limitations that are caused by differences in sampling approaches. Because the sample for our earlier report was selected judgmentally, the findings in that report reflect only information for the 134 claims we reviewed. On the other hand, our use of statistical sampling for this report allowed us to calculate national estimates. The significance of this is that because the two sampling approaches differed, differences in the sample results may, in part, reflect changes caused by the differing sampling methodologies rather than actual changes in loss adjustment performance by reinsured companies. This type of problem was largely unavoidable particularly because the first sample was selected judgmentally and would be difficult to duplicate a second time. Recognizing the differences between the sampling methodologies, we not only compared the sample results of all claims included in our past and current samples, but we also compared sample results for selected types of claims and for claims in similar locations. More specifically, we compared sample results for (1) soybean claims, which comprised a large proportion of both samples, and (2) soybean claims in Mississippi, a state and crop that was included in both samples.

will provide FCIC management with detailed information on each of the claims included in our review.

Also, to get some perspective on the accuracy of the loss adjustments performed by reinsured companies, we reviewed a nonstatistical sample of 22 master marketer claims adjusted by FCIC in each of the 4 states that we visited. The master marketer claims we reviewed were generally the largest claims in the same counties where we reviewed reinsured company claims, although only two were for $20,000 or more. We used the same FCIC expert assistance and the same methodology in readjusting losses on the master marketer claims that we used in readjusting losses on the reinsured company claims. The results from this sample cannot be generalized to all master marketer claims.

We conducted our work between November 1988 and July 1989 in accordance with generally accepted government auditing standards.

claims sampled in Mississippi—a state that was included in both reviews.

Table 2.1 summarizes information on nationwide overpayments and underpayments, which are estimated on the basis of our sample of 1987 claims of $20,000 or greater.

Table 2.1: Estimated Overpayment and Underpayment Rates for 1987 Crop Insurance Claims

	1987 claims sample[a]		
Overpayment or Underpayment	**"Best" estimate**	**Lower bound**	**Upper bound**
Percent of number of claims overpaid	63.6	34.1	93.1
Percent of dollar payments overpaid	16.5	0.4	33.8
Percent of number of claims underpaid	28.9	5.1	52.6
Percent of dollar payments underpaid	0.6	0.1	1.4

[a]Percentages are projected national estimates for all 1987 claims greater than $20,000. They are expressed in terms of a "best" estimate and lower and upper bounds around that estimate at the 95-percent confidence level

Table 2.1 indicates that our best estimate of the 1987 monetary overpayment rate is about 16 percent. However, because of our sample size, the actual value could fall anywhere between 0.4 and 34 percent. The probability is lower, however, of the actual overpayment rate being at either of the two extremes. Total 1987 crop insurance payments for claims of $20,000 or greater were about $100 million. We therefore estimate overpayments for such claims to be about $17 million (16.5 percent times $100.7 million). As table 2.1 also indicates, we estimate that about 64 percent of the 1987 claims for over $20,000 were overpaid while only about 29 percent were underpaid. The bias towards overpayment, as opposed to underpayment, is similar to our earlier findings.

In addition to comparing the overall results of our analysis from this review and our earlier one, we made two additional comparisons. Specifically, we compared the results of our analysis for one crop, soybeans, and for one state, Mississippi, which were included in both of our reviews. Both of these analyses further support our overall finding that the loss adjustment practices of reinsured companies have improved. For example, in our earlier report, we found that 43 percent of the $4.7 million in claim payments for 84 soybean claims of $20,000 or more were overpayments. On the basis of the 58 soybean claims in our current review, however, we estimate that about 22 percent[2] of the national

[2]The upper and lower bounds for this estimate are 47 and 1 percent, respectively.

Table 2.3: Frequency of Errors Found Regarding Determination of Eligibility, Production Guarantee, Actual Production, and Indemnity Due

Loss adjustment element	1984-85 sample[a] (percent of errors in sample)	1987 sample[b] (estimated percent of national errors)		
		"Best" estimate	Lower bound	Upper bound
Determination of production guarantee	54	52	29	75
Determination of actual production	36	33	27	39
Determination of indemnity due	7	10	[c]	26
Determination of eligibility	3	5	[c]	14
Total	**100**	**100**		

[a]Reflects percentage of the 269 errors found in the 134 judgmentally selected claims.

[b]Reflects estimated percentage of all errors nationwide for claims of $20,000 or greater. Percentages presented as "best" estimate and upper and lower bounds around that estimate at the 95-percent confidence interval.

[c]Less than 0.1 percent

A discussion of the types of errors we found in our current review as well as examples of each follows. Complete documentation for all errors found in our claim sample will be referred to FCIC so that it can take appropriate actions including obtaining repayment from the reinsured companies of the approximately approximately $400,000 in overpaid claims that we found.

Determining Production Guarantee

On the basis of our sample, the most frequent (52 percent) source of errors in 1987 claims of over $20,000 was associated with determining the production guarantee. This type of error was illustrated in an Arkansas soybean claim that we examined as part of our sample. The reinsured company's records showed the loss claim had been paid on the basis of the insured acreage of 692.2 acres. However, in reviewing supporting documentation and related records, we determined that the claim should have been based on only 672.2 acres. The 20-acre overstatement caused the production guarantee to be overstated by 308 bushels. As a result, the claim was overpaid by $1,443. Reinsured company representatives agreed with this finding and are pursuing collection of the overpayment. In commenting on a draft of this report, FCIC noted that some production guarantee errors may relate to production information certified by the producer and that it is currently reviewing possible changes to the certification process.

policy was written on the basis of an incorrect classification, the partnership may have been technically ineligible to receive the approximately $73,000 indemnity payment.

A reinsured company representative agreed that the finding was correct according to FCIC regulations. However, he thought the claim had been properly paid because the risk classification used belonged to the producer who actually planted and harvested the crop as opposed to the other partner who just contributed funds. Nonetheless, according to FCIC loss adjusters, regardless of who actually plants and harvests the crop, FCIC policy requires a new risk classification in such a situation.

In commenting on the draft report, FCIC noted that if the insurance policy application was made in good faith and the classification error was on the part of the corporation or company, the amount of overpayment may not be the entire amount of the claim but the difference between the actual paid claim and the claim based on the correct classification. FCIC stated that it needs to review the documentation before a final decision can be made.

Loss Adjustment Errors on Master Marketer Claims

To help provide a perspective on the quality of loss adjustment activities of reinsured companies, we examined 22 master marketer claims that had been adjusted by FCIC employees. We selected these claims judgmentally from those that had been paid in the counties included in our reinsured claim sample. Unlike the reinsured claims, only 2 of the master marketer claims we examined were for $20,000 or more. However, they generally represented the largest master marketer claim payments made in the counties we reviewed. We found that 6 of the claims had been overpaid resulting in overpayments of about $19,000, or about 12.6 percent, of the approximately $149,000 of claim payments we reviewed. While this overpayment rate is less than what we found in reinsured companies, it is higher than the 1.1 percent overpayment rate found in our previous report.[4] Underpayments for the master marketer claims we reviewed totaled less than 1 percent of the total claim payments reviewed.

Like the reinsured claims, the largest source of errors in the master marketer claims (about 39 percent) were associated with determining the production guarantee. We will provide FCIC complete documentation for

[4]In our 1987 report we examined 37 master marketer claims for payments totaling $1.7 million. We found that 17 were overpaid, resulting in overpayments totaling $25,000.

FCIC Actions to Strengthen Loss Adjustment Oversight

Since our earlier review, FCIC has taken a number of actions to improve its oversight of and control over the activities of reinsured companies. A principal action was to expand FCIC's Compliance Office, an action intended to help ensure that reinsured companies and master marketers comply with FCIC policies and requirements. In addition to several actions already taken, FCIC is planning to implement others that should further strengthen its oversight of the industry. This includes implementing a system of performance standards and sanctions. This system is intended to provide FCIC with uniform criteria for evaluating how well reinsured companies and master marketers are performing. It will also establish financial penalties for companies that fail to meet minimum standards and incentives for those companies that exceed specified performance levels.

Creating and Expanding a Compliance Office

One of several steps FCIC has taken to gain more effective oversight and control over reinsured companies was to establish a Compliance Office in 1986. Prior to creating this office, FCIC had virtually no means of knowing how well reinsured companies were implementing the federal crop insurance program. The Compliance Office carries out its oversight function through on-site evaluations of individual reinsured and master marketer company operations, which, among other things, could focus on loss adjustment, training, and financial controls. These evaluations normally include examining a sample of insurance claims or policies to determine if they were prepared and processed properly.

Since its creation, FCIC has strengthened the Compliance Office primarily through staff increases. The original office staff of 16 employees increased to 40 by the time we issued our earlier report in 1987 and is now at 64. FCIC plans to further increase the staff by approximately 17 employees during fiscal year 1990. Additionally, FCIC has expanded the number of regional compliance offices from two in 1986 to five in 1989. These offices are located in Kansas City, Missouri; Dallas, Texas; Sacramento, California; Raleigh, North Carolina; and St. Paul, Minnesota. Increases in staffing and regional offices have enabled the Compliance Office to review more reinsured company crop insurance claims and insurance policies for conformance with FCIC policy. For example, the Compliance Office reviewed only 113 claims and policies in 1986. During 1988, however, claims and policy reviews had increased to about 1,100.

performance is classified as superior, acceptable, provisionally acceptable, or unacceptable.

Under FCIC's current thinking, superior loss adjustment performance would require only that the company correct the errors identified in the sample of claims reviewed. This rating could also reduce the number and depth of future FCIC reviews. An acceptable rating would also require correction of identified errors but would not affect the scheduling of future FCIC reviews. Provisionally acceptable performance would require that the company retrain sales and loss adjustment personnel in addition to correcting errors found during the review. Further, FCIC would schedule a follow-up review to help ensure that loss adjustment problems had been addressed. With an unacceptable performance rating, FCIC would assume all loss adjustment responsibility for the geographic area covered by the compliance review. Additionally, FCIC would reduce the compensation received by a company for selling and servicing federal crop insurance to reflect that it was no longer performing loss adjustment functions. With this rating, FCIC could also suspend a company from writing any new crop insurance or terminate its contract entirely.

employees as compared to its current level of 64. FCIC plans to increase its Compliance Office staff to 81 employees by fiscal year 1990. Additionally, FCIC has increased the number of field sites of the Compliance Office from two to five in order to facilitate broader coverage. These and other expanded compliance activities could further reduce overpayment problems.

The progress FCIC appears to be making in this area should not signal a reduction in efforts to strengthen oversight and control over the crop insurance program. To do so, in our opinion, could thwart the progress already made and could jeopardize FCIC's ability to effectively protect the millions of federal dollars used to make crop claim payments each year.

We believe that the planned system of performance standards and penalties is an essential part of FCIC efforts to further improve oversight capabilities. Such a system, if properly implemented, will add some needed teeth to FCIC's ability to control the quality of the work done by reinsured companies by establishing criteria for taking action against companies not performing at an acceptable level. It will also penalize companies for unacceptable performance and, on the other hand, reward them for notable performance. As part of our 1987 and 1988 reports, we recommended that FCIC establish such performance standards. We therefore support FCIC's efforts in this area and encourage FCIC to implement its proposed system of performance standards and penalties as soon as possible. We believe that moving to this approach is long overdue and should significantly help overcome the continual problems FCIC management has encountered in this area.

Agency Comments and Our Evaluation

FCIC generally agreed with the report's conclusions about the progress made in its oversight activities. It also supported the need for continued strengthening of oversight activities until acceptable performance levels and overpayment rates are achieved. Additionally, FCIC agreed that performance standards and sanctions should be implemented immediately.

FCIC stated that the statistical estimates of overpayment rates may be questionable, if perceived as indicative of all claims. It noted that we sampled from claims of $20,000 or greater while the average 1987 claim amount was approximately $4,455. We sampled only large claims to ease comparison with our previous review, which also examined claims of $20,000 or more. Further, in 1987, claims of $20,000 or greater accounted for a significant portion of total dollar claim payments

5 times in 100. All estimates are based on formulas for three-stage sampling where sampling at each stage is done with replacement based on probability proportional to size.[1]

Table I.1: 1987 Large Reinsurance Claim Sample

State	County	Number of large claims in county	Number of claims reviewed	Number of claim selections made when sampling
Arkansas				
	Arkansas	1	1	
	Jackson	27	7[a]	7
	Lonoke	20	7	9
	White	13	4	6
	Pulaski	12	4	9
	Monroe	12	4	6
Georgia				
	Mitchell	3	3	
	Calhoun	34	27	71
	Cook	2	2	
	Dodge	3	3	
Illinois	Alexander	1	1	
	Jackson	2	2	
	Mercer	3	3	
	Franklin	2	2	
Mississippi				
	Monroe[b]	11	11	
	Lee[b]	11	11	
	Panola	4	4	
	Pearl River	7	7[a]	
		168	103	

[a]In Jackson County, Arkansas, we could not obtain information needed to review one of the claims selected for review. In Pearl River County, Mississippi, we excluded one claim from our review because it was the subject of a fraud investigation. Therefore, we completed reviews of 101 different claims.

[b]This county was selected for review twice. Each time the county was selected, all the claims in the county were included in the analysis.

[1]Ranjan Kumar Som, A Manual of Sampling Techniques (London: Heinemann Educational Books Ltd., 1973) was our primary source of formulas.

John W. Harman, Director 2

See comment 3.

The statistical projections made by GAO for the overpayment rate may be questionable, if perceived as indicative of the total FCIC book of business. FCIC believes that since the GAO's sample was selected from claims over $20,000, the overpayment rate projections may be somewhat high since most indemnity claim amounts are under $20,000. For example, the average amount of a reinsured company claim in 1987 was estimated to be approximately $4,455. The frequency at which claims over $20,000 occur, may affect any estimates of overpayment rates for FCIC as a whole.

FCIC is in agreement with GAO that the performance standards and related sanctions currently planned and developed, should be implemented immediately. FCIC has developed a final draft version of the performance standards and is currently awaiting for Office of General Counsel approval prior to implementation. FCIC is planning to incorporate references to the performance standards in all 1991 Agreements and Contracts. FCIC believes that establishing acceptable performance criteria will assist it to further distinguish those companies not performing at acceptable levels. FCIC anticipates proceeding with this action by January 1, 1990.

All appropriate actions will be pursued by FCIC in addressing the errors and over and underpayments identified by GAO during their audit. FCIC requests that GAO provide it with all supporting documentation which will permit it to make accurate and proper determinations of monies due the FCIC. Recovery action will be initiated upon receipt of the individual file supporting documentation and should be completed within 6-9 months after that date.

FCIC appreciate's the GAO's recognition of its oversight efforts and the need for continued emphasis in this area. FCIC believes it is gradually obtaining the program integrity needed to be successful.

JOHN MARSHALL

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The following are GAO's comments on the Federal Crop Insurance Corpo-
ration's letter dated September 13, 1989.

GAO Comments

1. FCIC's overall position on the report's findings is summarized on page
5 and 29 of the final report.

2. FCIC's comments on Actual Production History and eligibility are shown on pages 21 and 23 of the final report.

3. FCIC's comments on the statistical estimates as well as GAO's response to the comments are included on pages 5 and 29 of the final report.

Comments From the Federal Crop Insurance Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of Agriculture | Federal Crop Insurance Corporation | Office of the Manager | Washington, D.C. 20250

SEP 13 1989

TO: John W. Harman, Director
Food and Agriculture Issues,
Resources, Community and Economic Development Division
General Accounting Office

FROM: Manager

SUBJECT: FCIC Response To GAO Draft Audit
GAO/RCED-89-210: CROP INSURANCE: Loss Adjustment By Private Companies Improving, But Overpayments Are Still High

See comment 1.

FCIC is in general agreement with the audit report findings which recognize the efforts and progress made to date in its oversight activities, but also that continued emphasis and strengthening in the area of oversight activities needs to continue until acceptable performance levels and overpayment rates are achieved. FCIC believes that the continued direction of its oversight activities, along with the progress of several management initiatives, will provide the means for lowering overpayment rates. Many of the management initiatives currently being implemented by FCIC were identified in the GAO report, and FCIC is in agreement with the GAO that the full implementation of these initiatives will enhance its oversight effectiveness and render the results desired by all. FCIC believes these initiatives should be applicable to both its delivery systems, and therefore plans to implement the initiatives for both delivery systems.

See comment 2.

GAO's comments regarding eligibility of producer's who were not properly classified may not be fully correct. If the entity made application in good faith, and the classification error was on the part of the Corporation or the Company, the amount of overpayment may not be the entire amount of the claim but the difference between the actual paid claim and a claim based on the correct classification. Without the documentation available, FCIC reserves final judgement before agreeing with the GAO on this matter.

Errors associated with the Actual Production History (APH) program can be attributed in part to the fact it is a certification program by the producer. FCIC is currently studying the requirements of the APH program in line with comments and recommendations made by the Commission for the Improvement of Crop Insurance. Several recommendations made by the Commission, if implemented, would impact the current APH program.

The Federal Crop Insurance Corporation is an agency of the Department of Agriculture

Methodology for Selecting the 1987 Claim Sample

Our 1987 reinsurance claim sample was a three-stage design involving probability proportional to size (pps) sampling at each stage. As with an sample design, constraints on staff resources, budget, and time affected the number of states and counties where claims could be reviewed, as well as the ultimate number of claims reviewed. Our sample was selected from among the 2,626 "large" 1987 reinsurance claims occurring in 43 states. For purposes of our review, claims were considered large if the claim amount was at least $20,000. These large claims totaled about $100 million.

At each stage of selection, items were chosen with replacement and wit a selection probability proportional to the claim dollars represented by the item. Since we sampled with replacement, an item chosen for review was returned to the pool from which future selection would be made. Therefore, it was possible for a given item to be selected more than onc At the first stage of sampling, we made five state selections. Georgia, Mississippi, and Illinois were each selected once, while Arkansas was selected twice. The second stage of sampling involved choosing four to six counties from each selected state. Lastly, a certain number of claim within each selected county were chosen for review. If the total numbe of large claims in the county was fewer than 12, all claims were reviewed. If the total number of claims within each county was greater than or equal to 12, then a sample of claims was selected with replacement. Table I.1 presents, for each selected state and county, the total number of large claims in the county, the number of different claims reviewed, and the actual number of claim selections made in those cou ties where we sampled claims (with replacement).

For any given measure of interest, such as an overpayment rate, there are two important summary measures—a point estimate and a measu of the precision of the estimate, referred to as the sampling error. The point estimate is our best estimate while the sampling error allows us place bounds above and below the point estimate. The sampling errors are computed at the 95-percent confidence level. It is expected that under the same sample design, the true value for all large claims woul lie within the stated bounds 95 times out of 100. Of course, this also means that we risk not including the true value within the stated bou made—over one-third. We recognize that the estimates contained in this report apply only to claims of $20,000 or more and believe that we have carefully qualified our discussion throughout the report accordingly.

Conclusions, Agency Comments, and Our Evaluation

In 1987, we—as well as USDA's OIG—reported on major problems with the loss adjustment activities of reinsured companies. We stated that FCIC's lack of oversight and control led to millions of dollars of overpayments by reinsured companies. We concluded that FCIC's approach in dealing with reinsured companies was not working and that it had to take a more "hands on" approach. The wide-ranging recommendations included in our 1987 report and related testimony were aimed at putting FCIC back in control and reducing overpayments resulting from poor loss adjustment. The severity of the problems we reported prompted considerable congressional concern and pressure for FCIC to improve its control and oversight over this critical aspect of its program.

This review shows that improvements have been made but further improvements can be made. More specifically, our estimated overpayment rate of 16 percent for all 1987 claims of $20,000 or greater appears to be an improvement over the 31-percent overpayment rate found in our earlier review. However, the 16-percent rate still results in high levels of overpayments—about $17 million in 1987.

Overall, we believe that FCIC actions to strengthen its oversight and control over the loss adjustment practices of reinsured companies have played a significant role in helping to achieve the improved performance we found during our review. While it is difficult to pinpoint the reasons for the apparent improvement, we believe that the creation and continuing expansion of the FCIC's Compliance Office has gone a long way toward establishing the oversight presence that FCIC has needed in the industry. We think the effects of this presence were beginning to surface in the 1987 claims we reviewed. The rather alarming amount of overpayments found in our earlier review was based on claims from 1984 and 1985—prior to the creation of the Compliance Office. Before creating the office in 1986, FCIC had virtually no means of ensuring that reinsured companies complied with FCIC policies and procedures. However, with increased on-site evaluations of reinsured company operations, the Compliance Office now helps provide FCIC with needed oversight information to identify and correct loss adjustment problems. Further, the possibility of on-site evaluations acts as a deterrent against future loss adjustment problems.

Not all of FCIC's expanded compliance activities were in place in time to affect the 1987 sample of claims we reviewed. Consequently, their impact on loss adjustment overpayment rates may not be seen until 1988 or later claims are reviewed. For example, at the time the 1987 claims were adjusted, the FCIC Compliance Office was staffed with 40

Other Actions to Improve Oversight

In addition to establishing and strengthening its Compliance Office, FCIC has taken other steps to improve its oversight and gain control over reinsured company loss adjustment practices. For example, FCIC has established training and qualification guidelines for reinsured loss adjusters in an effort to improve the abilities of the personnel directly involved in settling claims. It has also begun to use computerized audits to screen claim payments for obvious errors, thus helping to ensure that payments are made only for eligible crops and numerical calculations for payments are correct.

Planned System of Standards and Sanctions

In our 1987 report, and in a subsequent 1988 report,[1] we noted that FCIC had not established criteria for determining acceptable loss adjustment performance by reinsured companies and recommended that such criteria be established. Our 1988 report stated that without performance standards, the results of FCIC compliance reviews could not be properly interpreted and that determining the circumstances under which it would take actions against a company became rather arbitrary. Since our prior reports, FCIC has drafted uniform performance standards and sanctions that will be applied to the results of its Compliance Office reviews of both master marketer and reinsured companies. FCIC plans to incorporate the performance standards and sanctions system in the 1991 contracts and agreements that take effect in July 1990.

While specific performance standards had not been finalized as of July 1989, FCIC was considering standards for reinsured company activities that would address, among other areas, loss adjustment, training for sales agents and loss adjusters, quality assurance programs (internal controls for ensuring that insurance policies and claims are processed properly), and record keeping. Proposed master marketer standards address similar areas except for loss adjustment.

Standards for evaluating a reinsured company's loss adjustment activities are designed to measure both the number of errors and dollar impact of errors found when the Compliance Office examines a sample of claims that were adjusted by a company. Specific standards are expected to be expressed in terms of (1) the percentage of the number of claims reviewed that were found in error and (2) the percentage of total dollar value of claim payments reviewed that were found to be in error. These percentages will determine whether a company's loss adjustment

[1] Crop Insurance: FCIC Needs to Improve Its Oversight of Reinsured Companies (GAO/RCED-89-10, Oct. 19, 1988).

these errors, as well as for all other types of errors found in our master marketer claim sample, so that it can take appropriate action to resolve the resulting over- or underpayments.

Determining Actual Production

The other large source of errors found during our 1987 review was ass ciated with determining actual production. We estimate that errors of this type constitute about 33 percent of all errors made on all 1987 claims for over $20,000. An illustration of this type of error occurred i an Illinois soybean claim we reviewed. The claim payment was original based upon actual production of 10,972 bushels, which was below the farmer's production guarantee of 20,643 bushels. However, a review o production records obtained at local grain elevators and discussions with growers revealed that the farmer had actually harvested about 26,800 bushels of soybeans. Because actual harvested production exceeded the production guarantee on three of the four units insured and decreased the loss on the fourth unit, the claim was overpaid by $33,958. Reinsured company officials are pursuing collection of this overpayment.

Determining Indemnity Due

The final step in the loss adjustment process is to determine the insured's indemnity. Once the production guarantee and the amount of actual production are determined, the adjuster should apply the price option to any difference and determine the insured's share or interest i the crop to arrive at the indemnity. We estimate that errors involving this part of the process comprise about 10 percent of all loss adjustmen errors made on 1987 claims. This type of error is illustrated in a Mississippi soybean claim we reviewed. In that case, the grower insured his crop and was paid an indemnity based on a 100-percent interest in the crop. However, review of production reports confirmed by the insured revealed that he had only an 80-percent interest in the crop. Consequently, we determined, and reinsured company officials agreed, that the incorrect share was the major error resulting in the claim being ove paid by $1,660.

Determining Eligibility

We estimate that, nationally, 5 percent of the loss adjustment errors involved eligibility problems. This type of problem was illustrated in a Georgia peanut claim we reviewed. We found that two farmers acting ir partnership were ineligible to be paid for a claim because they failed to obtain an appropriate risk classification factor at the time the insuranc policy was written. Risk classification factors are important because they establish the quantities of peanuts that can be insured. In this case instead of establishing a separate classification for the partnership as i required by FCIC procedures, the policy was written on the basis of the higher of the two farmers' individual risk classifications. Because the soybean claim payments of $20,000 or more are overpayments—a significant decrease since our earlier review. The overpayment rate for only those claims sampled in Mississippi also decreased since our prior review. In our 1984-85 claim sample, we examined 38 soybean claims in Mississippi for $1.4 million and found a monetary overpayment rate of 67.5 percent. On the basis of the 28 Mississippi claims in our 1987 sample, we estimate the overpayment rate for Mississippi soybean claims had decreased dramatically to 5.5 percent.[3]

Fewer Claims With Large Overpayments

In addition to a decline in overpayment rates, our current review indicates that fewer claims had large overpayments. For example, 33 percent of the claims overpaid in our previous sample were overpaid by $30,000 or more. On the basis of our current review, we estimate that 5 percent of the overpaid claims in 1987 exceeded that amount. Table 2.2 summarizes our estimates of the size of 1987 overpayments nationwide.

Table 2.2: Size of 1987 Overpayments by Reinsured Companies

	Estimated percent of overpaid claims nationwide[a]		
Amount of overpayment	"Best" estimate	Lower bound	Upper bound
$999 or less	17	3	31
1,000 - 9,999	50	16	85
10,000 - 29,999	27	[b]	57
30,000 - over	5	[b]	16
Total	**99**[c]		

[a]Percentages are national estimates for all overpaid 1987 claims. They are presented in terms of our "best" estimate and upper and lower bounds around that estimate at the 95-percent confidence interval.

[b]Less than 0.1 percent.

[c]Does not total 100 percent because of rounding.

Frequency of Loss Adjustment Errors

The frequency and distribution of loss adjustment errors appear to be relatively unchanged since our last review. In both reviews, the most frequent errors involved determining production guarantees and farmers' actual production. Table 2.3 summarizes information on the major types of errors found in both reviews.

[3]The upper and lower bounds for this estimate are 6 and 4 percent, respectively.

Loss Adjustment Practices Are Improving, but Overpayments Are Still High

Accurate loss adjustment is a critical part of the federal crop insurance program because it is the basis for paying millions of dollars in claims each year. Our review of 1984-85 claims illustrated significant problems in the quality of loss adjustment done by reinsured companies. Our current review indicates that the performance of reinsured companies has improved but that further improvements can be made. We estimate that, nationwide, about 16 percent of all 1987 claim payments for claims of $20,000 or more[1] were overpayments and should not have been made. This is a little over half the 31 percent overpayment rate found in our earlier review.

In comparing the results of this review with our earlier one, we also found that relatively fewer claims had large overpayments than in our previous review. Specifically, about 33 percent of the sampled claims in our prior review were overpaid by $30,000 or more. We estimate that, nationwide, about 5 percent of the 1987 claims for $20,000 or more were overpaid by that amount. The major causes of the loss adjustment errors that we found in our current review relate to determining the production guarantee and determining actual production.

Finally, in trying to get some perspective on the overpayment rate of reinsured companies, we did a limited examination of 22 master marketer claims. We found that for these 22 claims—totaling about $149,000—the overpayment rate was 12.6 percent (or about $19,000). While this is lower than the national rate we estimate for the reinsured companies, it is higher than the 1.1 percent overpayment rate we found in our earlier review of master marketer claims.

Overpayment Rates Are Decreasing but Still Appear High

Our review of a statistical sample of 1987 claims indicates that overpayments by reinsured companies may have decreased since our earlier review. On the basis of the 1987 claim sample, we estimate that nationwide, about 16 percent (or about $17 million) of all payments for claims of $20,000 or more were overpayments. This is substantially less than the 31-percent overpayment rate found in our previous judgmental sample of 1984-85 claims. Other analyses of the results of the two samples also indicate improved loss adjustment. For example, overpayments for soybean claims only—a type of claim comprising at least half of the claims in each sample—also appeared to have decreased. Further, similar improvements were noted when comparing the results for soybean

[1] In 1987 there were 2,626 total claims of $20,000 or greater nationwide. Payments for these claims totaled about $100 million.

We selected our 1987 sample of claims in three phases. In the first phase, we identified a sample of states; in the second, we identified a sample of counties within the sampled states; and, in the final phase, we sampled claims within the selected counties. The specific sampling technique used in each phase is known as probability proportionate to size (PPS) sampling. Using this technique, the probability (likelihood) of being selected as part of the sample is proportionate to size or value (in this case the value of claim payments). For example, during the first phase, the probability of a state being selected was proportional to its share of the national dollar value of all crop insurance claims of $20,000 or more. The larger the dollar value, the more likely a state's chances were of being selected for our sample. The same sampling technique was used to identify counties and individual policies within those counties. That is, the larger the value of claim payment(s) within a county or for a particular policy, the more likely that county or policy would be selected for review.

Because we could look at only a sample of claims, the national estimates made from our sample are subject to sampling error or variability. This report presents sample results in terms of our best estimate and upper and lower bounds to that estimate. All estimates based on the 1987 reinsurance claim sample and their sampling errors were calculated using appropriate formulas based upon the sample design. The upper and lower bounds represent the limits of the 95-percent confidence interval. The true value falls between these bounds 19 times out of 20. Details on our sampling approach can be found in appendix I.

To evaluate the accuracy of the adjusted claims, we enlisted the assistance of FCIC experts. (This was similar to what we did in our prior review.) Working with these technical experts, we obtained all relevant paperwork in support of each claim and then recomputed the amount that should have been paid on each of the 101 claims in accordance with the loss adjustment procedures and methods used by FCIC. We readjusted the loss on each claim and compared the results with the claim amounts adjusted by the reinsured companies to determine whether an overpayment or underpayment had occurred. In readjusting the losses, where necessary, we discussed the claim with the insured, the agent who sold the policy, the reinsured company loss adjuster, and third parties, such as grain elevator operators, with knowledge bearing on the claim. Also, we presented our individual claim review results to the responsible reinsured companies and discussed our findings with their representatives. Their comments were taken into account throughout this report and are reflected as appropriate. In addition, at the conclusion of our audit, we monitoring and evaluating the activities of reinsured companies, (2) strengthening reinsured company procedures for training loss adjusters and supervising quality reviews, and (3) establishing internal controls over reinsured claims prior to payment.

In addition to our review, the USDA's OIG also evaluated reinsured company loss adjustment practices and found similar problems. The OIG's 1987 report noted that (1) 86 claims, or about 70 percent, of the 125 cases reviewed had been adjusted incorrectly and (2) $5.1 million, or 50 percent, of the $10.2 million claim payments reviewed were overpayments. It concluded that FCIC generally lacked effective controls to ensure compliance with its loss adjustment procedures and recommended, among other things, that FCIC strengthen controls over loss adjustment by strengthening its oversight over the loss adjustment practices of reinsured companies. Our findings, and those of the OIG, focused congressional concern on loss adjustment problems and pressured FCIC to improve its control and oversight of reinsured company activities. Since our earlier review, FCIC has made several improvements in the crop insurance program.

Objectives, Scope, and Methodology

We conducted this review at the request of the Chairman, Subcommittee on Conservation, Credit and Rural Development, House Committee on Agriculture (who at the time of the request was the Chairman, Government Information, Justice and Agriculture Subcommittee, House Committee on Government Operations). Our objective was to determine whether loss adjustment practices of reinsured companies had improved since our 1987 testimony and report.

To meet this objective, we selected a sample of 101 1987 crop year claims (the latest available claims at the time of our review) and, with the assistance of FCIC crop loss adjustment experts, reviewed them to determine if they had been adjusted properly. We then compared the results of this analysis with our previous sample of 134 1984-85 claims, which formed the basis of our earlier report. For both this report and our prior report, our samples were selected from claims of $20,000 or greater. Table 1.1 summarizes information on both samples.

or reviewing aerial maps and/or acreage reports maintained by the ASCS county officer.[4]

The farming practice determination is important because it affects the guaranteed per-acre production of the farm. The type(s) of farming practice assigned to a policy varies by area and crop but generally depends on whether or not the crop is irrigated, planted in rows or broadcast (scattered), and planted after the harvesting of another crop. The agent should verify the farming practice used through either a visit to the farm or review of ASCS acreage reports certified by the producer.

The guaranteed per-acre production of a farm is also affected by its physical location. Some farms, for example, are located on more productive land than others. FCIC has actuarial tables that can be used to calculate the productive capacity of farms in various geographic locations. The agent is responsible for ensuring that the appropriate tables are used and that the calculations are accurate.

Determining Actual Production

When a farmer notifies the company of a claim, the adjuster is responsible for determining the producer's actual production. Actual production is the total number of bushels or tons of crop harvested, plus any potential production from unharvested acres, less normally minor adjustments to account for moisture, foreign matter, and other impairments to crop quality.

To determine the amount of actual production, the adjuster should obtain the producer's records to determine the harvested production sold or stored for sale at a later date. If production reported by the producer appears unreasonable based on production of comparable farms, the adjuster is required to take additional steps to verify production. One step FCIC requires under such circumstances is to canvass entities, such as grain elevators or processors, where the producer may have sold the crop. Any additional production the adjuster finds that can be attributed to the insured's farm is included in the determination of actual production. Finally, applicable quality adjustments are made to arrive at a final production figure.

[4]ASCS requires producers that participate in certain farm programs to submit acreage reports (ASCS Form 578) to its county officer.

In 1988, reinsured companies accounted for about 85 percent of all crop insurance business, and master marketers accounted for about 15 percent. From 1984 through 1988, premium income from policies sold by reinsured companies totaled about $1.5 billion, and indemnities, or claims, totaled about $2.5 billion. During the same period, premium income on policies sold by master marketers totaled about $531 million, and indemnities about $880 million.

Program Funding

FCIC receives funds from three primary sources—premium income from producers purchasing insurance policies, the issuance of capital stock, and federal appropriations. The 1980 act authorizes FCIC to issue and sell $500 million in capital stock, which is to provide working capital and a reserve to cover losses when premium income and/or reserves are insufficient. Because of its large losses, FCIC had issued and sold all of the capital stock to the U.S. Treasury by fiscal year 1985. In addition, FCIC borrowed $1.7 billion from USDA's Commodity Credit Corporation (CCC)[3] at various times through 1988.

Insurance Coverage

Federal crop insurance can help mitigate the effects of crop losses caused by unavoidable natural hazards, but it does not insure profit for the producer or cover avoidable losses resulting from negligence or failure to observe good farming practices. Crop insurance is generally provided at three coverage levels—50, 65, or 75 percent of the farm's recorded or appraised average yield—and at three different target price elections (dollar value per unit of production), with one being not less than 90 percent of the projected market price for the crop insured. In all, the producer has nine insurance options. The insurance guarantees the producer a certain amount of coverage for production—in bushels or pounds—per acre. Farmers' premiums are due at time of harvest. If a farmer is paid for a loss on a claim, the premium due is deducted from the claim payment.

[3]The CCC is a wholly owned government corporation created to stabilize, support, and protect farm prices and farmers' income. CCC funds the various price-and-income-support programs and relies on ASCS personnel and facilities to carry out the programs.

Chapter 1

Introduction

American farmers face many uncontrollable natural hazards that can prevent planting or destroy crops. Crop insurance provides protection to agricultural producers from losses caused by unavoidable disasters, such as insects, disease, fire, hail, drought, floods, freezing, and wind. The U.S. Department of Agriculture's (USDA) Federal Crop Insurance Corporation (FCIC), a government-owned corporation, was created in 1938 to promote the national welfare by improving the economic stability of agriculture through a sound program of federal crop insurance.

Before 1980, the crop insurance program operated on a limited basis covering certain commodities and selected counties. Since the passage of the Federal Crop Insurance Act of 1980, however, FCIC greatly expanded its insurance coverage to virtually all major crops across the United States. During this time, FCIC shifted its sales and service delivery system primarily to private companies that it reinsures. As a reinsurer, FCIC is largely responsible for all losses on crop insurance policies and, as a result, has a vital interest in ensuring that the reinsured companies are properly adjusting losses (settling claims for crop damage covered under the insurance policies).

In 1987 testimony and a subsequent report,[1] we noted that FCIC was losing millions of dollars through the poor loss adjustment practices of reinsured companies. At the request of the Chairman Subcommittee on Conservation, Credit and Rural Development, House Committee on Agriculture, this report evaluates whether or not the loss adjustment practices of reinsured companies have improved since our earlier work.

Federal Crop Insurance Corporation's Insurance Program

The 1980 act provides for an insurance program for agricultural producers to protect their production investment against essentially all unavoidable risks. The act requires that the program be operated on an actuarially sound basis with premium income sufficient to cover losses and to establish, as expeditiously as possible, a reasonable reserve against unforeseen losses. Also, the 1980 act requires that FCIC shall, among other things

- use the private sector, to the maximum extent possible, to sell and service crop insurance policies and

[1] Assistant Comptroller General, Resources, Community, and Economic Development Division, J. Dexter Peach testified before the Subcommittee on Conservation, Credit and Rural Development, House Committee on Agriculture, on Apr. 29, 1987; the report was entitled Crop Insurance: Overpayment of Claims by Private Companies Costs the Government Millions (GAO/RCED-88-7, Nov. 20, 1987).

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FCIC Actions Seem to Be Improving Loss Adjustment Practices

The 1987 GAO report and testimony, as well as other government audit reports, focused congressional attention on loss adjustment problems and created considerable pressure for FCIC to improve oversight and control of reinsured companies. Since these reports, FCIC has strengthened its oversight functions, which, GAO believes, has contributed to the loss adjustment improvements found in its current review.

One of the most important steps FCIC has taken toward improving its oversight and control over the loss adjustment practices of reinsured companies was to create and expand its enforcement arm—the Compliance Office. This office was established in 1986 to help ensure that reinsured companies comply with FCIC policies and practices. Its work is conducted primarily through on-site evaluations of company operations—including loss adjustment. The Compliance Office was not created, however, until 1986 and could not have affected the 1984-85 claims in GAO's previous review. In fact, at the time of GAO's earlier review, FCIC had virtually no oversight of the operations of reinsured companies.

Since its creation in 1986, the Compliance Office has been strengthened through increased staffing—from 16 staff members to its current level of 64. GAO believes that the benefits of this strengthened oversight function are reflected in the decreased overpayment rates found in GAO's current review.

Other FCIC Initiatives May Result in Further Improvements

Not all of FCIC's expanded compliance activities were in place in time to affect the 1987 sample of claims that GAO reviewed. Consequently, their impact on loss adjustment overpayment rates may not be seen until 1988 or later claims are reviewed. For example, at the time the 1987 claims were adjusted, the FCIC Compliance Office was staffed with 40 employees as compared to its current level of 64. FCIC plans to add 17 more employees to its Compliance Office during fiscal year 1990. Additionally, FCIC has increased the number of field sites for the Compliance Office from two to five to facilitate broader coverage. These and other expanded compliance activities could further reduce overpayment problems.

FCIC is planning to take additional measures that should increase the effectiveness of its oversight and control function. Specifically, FCIC is developing a system of performance standards and penalties. Among other things, the standards will provide uniform criteria for evaluating the loss adjustment performance of reinsured companies. FCIC will use

Executive Summary

Purpose

The federal crop insurance program insures farmers against unavoidable losses due to adverse weather, insects, and crop disease. The program is implemented largely through private companies that are reinsured by the Federal Crop Insurance Corporation (FCIC). As a reinsurer, FCIC pays for most of the insurance losses and, as a result, has a vital interest in ensuring that the private companies are properly adjusting losses (settling claims for crop damage covered under the insurance policies).

In 1987 testimony and a subsequent report, GAO criticized the loss adjustment practices of reinsured companies, noting that they were costing the federal government millions of dollars in overpaid crop insurance claims. As a result of these findings, the Chairman of the Subcommittee on Conservation, Credit and Rural Development, House Committee on Agriculture, asked GAO to conduct a follow-up evaluation of reinsured company loss adjustment practices to determine if they had improved.

Background

Proper loss adjustment is essential to a financially sound crop insurance program. Its importance is particularly significant in light of the financial difficulties FCIC is experiencing. For example, from 1984 through 1988, insurance claims (indemnities) totaled about $3.4 billion compared with premium income of about $2 billion—a net loss of almost $1.4 billion.

In response to a congressional request, GAO, in 1987, reviewed a judgmental sample of 134 1984-85 crop insurance claims to determine how accurately reinsured companies adjusted claims. It found, among other things, that 95 percent of the claims had been adjusted improperly resulting in overpayments totaling $3 million. This represented an overpayment rate of about 31 percent of the total $9 million in claim settlements reviewed. GAO made several recommendations to the Secretary of Agriculture aimed at requiring FCIC to increase oversight and control over the loss adjustment activities of reinsured companies.

Results in Brief

The loss adjustment activities of reinsured companies appear to be improving although further improvements can be made. While the actual overpayment rate could vary widely, GAO estimates, on the basis

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