



RMA Indemnity Payments to Pistachio Producers

Audit Report 05601-0001-41

OIG reviewed pistachio producers' reported actual production on insured harvests, insurance claims, and indemnity payments.

OBJECTIVE

Our objectives were to determine if selected (1) producers accurately reported actual production on insured pistachio harvests, (2) pistachio crop insurance claims were adjusted in accordance with RMA procedures, and (3) indemnity payments to producers were accurate.

REVIEWED

We reviewed documentation provided by five AIPs who submitted claims for indemnities paid to twelve producers who suffered losses to pistachio crops in crop year (CY) 2015. We performed audit fieldwork from March 2017 to September 2017, at RMA's national office, product management offices, Western Region Compliance Office and at one AIP.

RECOMMENDS

We recommend that RMA require the AIP include adequate evidence to support post-harvest field inspections and if adequate supporting evidence is not available, recover from the AIP approximately \$7.7 million in indemnities paid to the four producers. We also recommend that RMA require the AIP to provide staff with training on documentation that must be included in claim files to support losses.

WHAT OIG FOUND

The Department of Agriculture's (USDA) Risk Management Agency (RMA) promotes the economic stability of agriculture through the Federal Crop Insurance Corporation (FCIC). RMA's mission is to deliver crop insurance programs to agricultural producers with effective, market-based risk management tools that strengthen producers' economic stability. In 2011, FCIC approved a pilot program for the delivery of actual production history crop insurance for pistachios.

The Office of Inspector General (OIG) found that four of five producer claim files from one approved insurance provider (AIP) did not contain the required evidence to support the paid insurance indemnities. Specifically, three claim files did not contain sufficient evidence of the loss adjuster's field inspections, and four claim files did not contain evidence documenting the loss adjuster's determination that all trees were completely harvested.

According to the AIP, this occurred because AIP staff did not include the required documentation in the respective claim files. As a result, indemnity payments of nearly \$7.7 million paid to four producers are questionable.

RMA officials generally concurred with our recommendations, and we accepted management decision on one of the two recommendations in the report.



United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: February 20, 2018

AUDIT
NUMBER: 05601-0001-41

TO: Heather L. Manzano
Acting Administrator
Risk Management Agency

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: RMA Indemnity Payments to Pistachio Producers

This report presents the results of the subject audit. Your written response to the official draft report is included in its entirety at the end of this report. Your response and Office of Inspector General's (OIG) position are incorporated into the relevant sections of the report. Based on your written response, we are accepting management decision on Recommendation 2; however, management decision has not been reached for Recommendation 1. The actions needed to reach management decision for this recommendation are described under the relevant OIG Position section.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendation for which management decision has not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. For agencies other than OES, please follow your internal agency procedures in forwarding final action correspondence to OES.

We appreciate the courtesies and cooperation extended to us by members of your staff during our audit fieldwork and subsequent discussions. This report contains publicly available information and will be posted in its entirety to our website (<http://www.usda.gov/oig>) in the near future.

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Background and Objectives

Background

The Department of Agriculture's (USDA) Risk Management Agency (RMA) promotes the economic stability of agriculture through the Federal Crop Insurance Corporation (FCIC), a government-owned corporation whose purpose is to promote the national welfare by improving the economic stability of agriculture with effective market-based risk management tools. On April 4, 1996, the Federal Agriculture Improvement and Reform Act created RMA as an independent office responsible for the administration and oversight of FCIC programs.

Federal crop insurance provides an actuarially-sound risk management program designed to reduce agricultural producers' losses due to unavoidable causes (for example, drought, excessive moisture, hail, tornado, lightning, etc.) and loss of revenue due to reduced prices or reduced yields. RMA strengthens producers' stability by re-insuring¹ crop insurance policies sold by private approved insurance providers (AIPs). AIPs sell crop insurance policies to producers who choose to indemnify their eligible crops against potential losses. FCIC subsidizes a portion of the policies' premiums under a FCIC-backed Standard Reinsurance Agreement (SRA). SRA establishes terms and conditions under which FCIC provides premium subsidies, expense reimbursement, and reinsurance to AIPs. In addition, SRA provides policies and procedures for selling insurance policies and processing and adjusting insurance claims.

On September 22, 2011, FCIC approved a pilot program for the delivery of actual production history (APH) crop insurance² for pistachios beginning with crop year (CY) 2012. The pilot program currently covers policies sold to pistachio producers in Arizona, California, and New Mexico. Pistachios are an alternate bearing crop, which means they typically produce a high yield one year followed by a reduced yield the next year, and pistachio crop insurance policies are sold in two-year modules that require the producer to insure the crop for both years. Eligible producers can elect to receive either basic catastrophic insurance, which covers 50 percent of the approved yield and 55 percent of the price election, or pay a premium to purchase increased levels of insurance, which cover 50 to 75 percent of the approved yield and 55 to 100 percent of the price election. In order for pistachio crops to be insurable, the trees must have reached their tenth leaf year³ and have at least four years of documented production history.

When pistachio producers incur losses or damage to crops, they must notify their respective AIP no later than 15 days prior to the beginning of the harvest, or immediately upon discovery of

¹ Reinsurance provides a way for the insurance company to protect itself from financial disaster and ruin by passing on the risk to other entities (e.g., RMA).

² APH crop insurance policies insure producers against yield losses due to natural causes as discussed above. If actual harvested (plus appraised) production is less than the insured yield, the producer is paid an indemnity based on the difference.

³ A leaf year for pistachio trees is calculated by subtracting the year the trees were set out (grafted) from the current crop year and adding one year.

damage, if the harvest has begun. Following a reported loss, RMA's *Loss Adjustment Manual* (LAM) directs AIPs to conduct final inspections of damaged crops (via field visits) to "document production, acreage, insured and uninsured causes of loss, and all other pertinent entries to determine the amount of the indemnity." When the harvest is complete, AIP loss adjusters calculate losses by subtracting actual production from guaranteed production. RMA also publishes the *Loss Adjustment Standards Handbooks* (LASH) that provide loss adjustment standards, including claims completion instructions, for specific crops.

The National Agricultural Statistics Service reports domestic pistachio production increased from 110 million pounds in 1999 to 551 million pounds in 2012; with California accounting for 98 percent of the total. During CYs 2013-2015, FCIC paid indemnities to pistachio producers in excess of \$217 million (approximately \$4.7 million in CY 2013, \$19.9 million in CY 2014, and \$193 million during CY 2015) with over 99 percent of payments paid in California for CY 2015.

In CY 2015, three factors were present in California's central valley that contributed to reduced pistachio production and as a result an increase in indemnity payments. The first factor was a natural weather phenomenon that resulted in a lack of winter chilling hours. Pistachio trees need at least 800 hours of cool weather (less than 45 degrees) during the winter to rest or set. Second, as a result of a warmer than usual winter, male (pollinator) and female (producing) trees did not bloom at the same time. Therefore, many female trees were not pollinated, resulting in reduced production. Finally, the California central valley has suffered from an extended drought.⁴

The Improper Payments Elimination and Recovery Act of 2010 (IPERA) required agencies to identify programs that may be susceptible to significant improper payments⁵; the Federal crop insurance program was identified as one of the USDA programs susceptible. Crop insurance is a self-certification program and the threat of fraud, waste, or abuse is inherent. RMA conducts IPERA reviews as required by statute and to maintain public confidence in the program. As part of the IPERA review process for pistachios, the RMA Western Region Compliance Office conducted 19 reviews of pistachio claims under IPERA and did not identify any systemic problems.

Objectives

Our objectives were to determine if selected (1) producers accurately reported actual production on insured pistachio harvests, (2) pistachio crop insurance claims were adjusted in accordance with RMA procedures, and (3) indemnity payments to producers were accurate.

Based on our review, nothing came to our attention to indicate that producers improperly reported actual production on insured pistachio harvests. Furthermore, we did not identify any issues that indicated the IPERA process was not operating as prescribed.

⁴ Severe drought conditions existed in the California central valley between 2012 and 2015.

⁵ The IPERA defines the term "significant" as improper payments in a program or activity in the preceding fiscal year that may have exceeded \$10,000,000 of all program or activity payments made during that fiscal year *and* 2.5 percent of program outlays; or may have exceeded \$100,000,000.

Section 1: Inadequate Support for Loss Claims

Finding 1: Loss Adjuster Did Not Adequately Document Support for Claims

Four of five producer claim files submitted by one AIP did not contain all documentation required to support insurance indemnities paid. According to the AIP, this occurred because AIP staff did not include the required documentation in the respective claim files. As a result, indemnity payments of \$7,667,067 paid to the four producers are questionable.

RMA's LAM requires loss adjusters to "Visit farms for the purpose of inspecting damaged or destroyed crops during the growing season or following harvest." LAM continues on this theme by requiring loss adjusters to "Inspect insured crops and make inquiries to independently establish all harvested, unharvested, and potential production for all units of the crop being inspected...."⁶ LAM specifically requires loss adjusters to "Do a visual inspection of the harvested fields to determine whether there is an excessive amount of production remaining...."⁷ Furthermore, LAM requires officials who perform loss adjustments to "Verify and/or determine *and document* the information specified in [the LAM] or other FCIC-issued procedures necessary for loss adjustment [OIG emphasis added]."⁸

During the audit, we reviewed documentation provided by 5 AIPs supporting \$88,578,689 in claims for indemnities paid to 12 producers who suffered losses to pistachio crops in CY 2015. We found no issues with the documentation maintained for the seven sampled claims processed by four of the five AIPs. However, with one AIP, we determined that all required supporting documentation for four of the five producer claims was not included in the claim files. Specifically, three claim files did not contain sufficient evidence of the loss adjuster's field inspections and four claim files did not contain evidence documenting the loss adjuster's determination that all trees were completely harvested. We found the four claim files were prepared by the same loss adjuster.

When we asked an AIP representative why documentation of post-harvest field inspections and evidence that all trees were completely harvested was not included in the claim files, the AIP's Chief Executive Officer (CEO) stated the information included in the claim files was sufficient to support the claims. Following further discussion, the CEO subsequently agreed the files did not contain the required supporting documentation and acknowledged this occurred due to oversight by both the loss adjuster and the claims reviewer.

⁶ USDA FCIC, *Loss Adjustment Manual (LAM) Standards Handbook*, § 8.B (6) and § 8.B (8) (d), "Loss Adjustment Responsibilities," 25010 (November 2013).

⁷ USDA FCIC, *Loss Adjustment Manual (LAM) Standards Handbook*, § 212.B(3), "Verifying Total Production—Appraised or Harvested," 25010 (November 2013).

⁸ USDA FCIC, *Loss Adjustment Manual (LAM) Standards Handbook*, § 8.B (2), "Loss Adjustment Responsibilities," 25010 (November 2013).

In conclusion, RMA should ensure this AIP includes adequate evidence to support post-harvest field inspections and evidence that all trees were completely harvested in order for these claims to be eligible for crop insurance (or to be reinsured). If adequate supporting evidence is not available, RMA should recover from the AIP approximately \$7.7 million in indemnities paid to the four producers. RMA should require this AIP to provide the loss adjuster and the claims reviewer with training on documentation that must be included in claim files to support losses.

Recommendation 1

Ensure the Approved Insurance Provider (AIP) includes adequate evidence to support post-harvest field inspections and evidence that all trees were completely harvested for these claims. If adequate supporting evidence is not available, recover from the AIP \$7,667,067 in indemnities paid to the four producers.

Agency Response

In its written response, dated January 23, 2018, RMA generally concurred with this recommendation. On subsequent review, the agency verified that two of the four claim files did not contain adequate supporting evidence for all units within these claims. RMA agreed to establish an accounts receivable with the agency's Reinsurance Accounting and Operations Branch for collections.

OIG Position

We agree with RMA's corrective action. To achieve management decision, RMA needs to provide OIG with a copy of the established receivable for any outstanding indemnity.

Recommendation 2

Require the AIP to provide both the loss adjuster and the claims reviewer with training on documentation that must be included in claim files to support losses.

Agency Response

In its written response, dated January 23, 2018, RMA concurred with this recommendation. The agency agreed to send a letter to the AIP by January 31, 2018, requiring the AIP to provide additional training to the loss adjuster and claims reviewer that identifies the correct documentation to be included in a claim file to support losses. RMA will require the AIP to respond with documentation supporting the completion of this training and the date the training was completed, by March 1, 2018.

OIG Position

We accept management decision for this recommendation.

Scope and Methodology

We conducted a nationwide review of RMA indemnity payments to pistachio producers. The scope of our audit work covered indemnity payments made to California producers for crop year (CY) 2015 losses.⁹ We performed fieldwork with officials at RMA's national office in Washington, D.C., and with officials at the agency's Product Management offices in Kansas City, Missouri. We also performed fieldwork at RMA's Western Region Compliance Office (WRCO) and at one AIP in California. We conducted audit fieldwork from March 2017 to September 2017.

RMA paid indemnities of \$193,092,662 on 276 insurance policies to AIPs for CY 2015 pistachio losses in California and Arizona; of those, 272 insurance claims totaling \$192,968,206 were paid to California producers. We non-statistically selected the largest 4 of 19 (21 percent) pistachio claims from different producers that were included in RMA's Improper Payments Elimination and Recovery Act (IPERA) review process.¹⁰ We also non-statistically selected the 6 largest pistachio claims from the universe of the remaining 253 claims that did not receive IPERA reviews. We expanded our sample of 10 by including the claims of 2 additional producers who had partnership agreements with a producer in our sample of non-IPERA claims. Our 12 sampled indemnity claims were serviced by 5 of 9 (55.6 percent) AIPs that operated in California in CY 2015. The value of the 12 sampled indemnity claims represents \$88,578,689 of the \$193,092,662 (45.9 percent) of indemnities paid for CY 2015 pistachio losses. We designed our reviews to evaluate compliance with program regulations and policies related to the claims adjustment and indemnity calculation process.

To accomplish our objectives, we performed the following steps and procedures:

From the RMA national office, we:

- Obtained and reviewed pertinent laws, regulations, and guidance applicable to the program;
- Interviewed key personnel to gain an understanding of the program and discussed AIP roles and responsibilities with regard to verification of losses and calculation of indemnities on insured pistachio crop losses; and
- Identified RMA national office management controls regarding the Pistachio Pilot program.

From the RMA Product Management Office, we:

⁹ In CY 2015, RMA indemnities paid on pistachio losses rose 846 percent from the previous year. Likewise, RMA's loss ratio (a measure of the percentage of losses paid from year to year) for pistachio indemnities rose nearly 594 percent in CY 2015.

¹⁰ The RMA WRCO conducted 19 IPERA reviews of CY 2015 indemnity claims to pistachio producers in 2015 and 2016.

- Obtained background information about the pistachio indemnity program to determine how the program was developed and problems incurred during the development process;
- Identified factors that affected pistachio yields during our scope period to determine what caused the increase in losses;
- Documented RMA's thoughts on producer and AIP concerns to determine the potential for future program changes; and
- Identified the types of reviews performed by RMA to determine the adequacy of RMA oversight.

At the RMA WRCO, we:

- Interviewed WRCO personnel to gain an understanding of their role in verifying that pistachio claims submitted by AIPs were properly established and adjusted;
- Interviewed key personnel to determine how the IPERA review process is conducted;
- Obtained and reviewed records and supporting documents of four pistachio claims reviewed under IPERA;¹¹ and
- Obtained data for all pistachio indemnity payments made in California for CY 2015 to identify our scope.

At one AIP, we:

- Reviewed and assessed the adequacy of AIP guidance for the loss adjustment process;
- Analyzed summary information from the AIP's Plan of Operations that describes underwriting, loss adjustment, and Quality Control review policies; and
- Assessed the AIP's loss adjustment policies and procedures to determine if they were adequate for pistachio crop insurance policies and in compliance with laws and regulations.

For each claim file, we:

- Evaluated the propriety and accuracy of AIP indemnity payment calculations for selected claims;
- Reviewed supporting documentation and evaluated the accuracy of AIP calculated average and approved actual production history yield for selected claims;
- Evaluated the accuracy of AIP determinations of sample producer eligibility, including: insurable share, insurable cause of loss, and age of trees;

¹¹ We obtained supporting documents for the remaining eight non-IPERA claims electronically from AIPs.

- Verified that supporting documentation from independent entities (for example, pistachio processing facilities) was included in the claim files to confirm reported production to count; and
- Evaluated the adequacy of documentation that supported each claim.

During the course of our audit, we did not verify information in any agency information systems, and we make no representation regarding the adequacy of any agency computer systems because the primary agency information system used, the Compliance Activities and Results System, is a storage location which relies on AIP generated, uploaded, and updated information. Not reviewing this system did not impact the results of this audit.

We conducted this audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Abbreviations

AIP	Approved Insurance Provider
APH.....	Actual Production History
CEO.....	Chief Executive Officer
CY.....	crop year
FCIC.....	Federal Crop Insurance
IPERA.....	Improper Payments Elimination and Recovery Act of 2010
LAM.....	Loss Adjustment Manual Standards Handbook
LASH.....	Loss Adjustment Standards Handbook
OIG.....	Office of Inspector General
RMA.....	Risk Management Agency
SRA.....	Standard Reinsurance Agreement
USDA.....	Department of Agriculture
WRCO.....	Western Region Compliance Office

Exhibit A: Summary of Monetary Results

Exhibit A summarizes the monetary results for our audit report by finding and recommendation number.

Finding	Recommendation	Description	Amount	Category
1	1	Payments made to producers without adequate supporting documentation	\$7,667,067	Unsupported Costs and Loans, Recovery Recommended
Total			\$7,667,067	

**AGENCY'S
RESPONSE TO AUDIT REPORT**



United States Department of Agriculture

Farm Production and Conservation
Risk Management Agency

January 23, 2018

TO: Gil H. Harden
Assistant Inspector General for Audit
Office of Inspector General

FROM: Heather Manzano
Audit Liaison Official
Risk Management Agency

SUBJECT: Office of Inspector General Audit 05601-0001-41, Draft Report, RMA Indemnity Payments to Pistachio Producers

RMA requests Management Decision for Recommendation 1 and 2 for OIG Audit 05601-0001041, RMA Indemnity Payments to Pistachio Producers.

RECOMMENDATION 1

Ensure the Approved Insurance Provider (AIP) includes adequate evidence to support post-harvest field inspections and evidence that all trees were completely harvested for these claims. If adequate supporting evidence is not available, recover from the AIP \$7,667,067 in indemnities paid to the four producers.

RMA RESPONSE TO RECOMMENDATION 1

RMA has reviewed the four policy claim files recommended by OIG. During our review, RMA determined two policy claim files contained adequate documentation. RMA obtained additional documentation and photographic evidence from the insurance provider that verified that the units were clean harvested. Conversely, RMA determined that two claim files did not contain adequate supporting evidence for all units within the claim. RMA will write initial findings to recover partial indemnities for the respective units by February 2, 2018, and set up accounts receivable with RMA's Reinsurance Accounting and Operations Branch for collections.



Deputy Administrator for Compliance
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RECOMMENDATION 2

Require the AIP to provide both the loss adjuster and the claims reviewer with training on documentation that must be included in claim files to support losses.

RMA RESPONSE TO RECOMMENDATION 2

RMA concurs with Recommendation 2 and will send a letter to the AIP by January 31, 2018 requiring the AIP to provide additional training to the loss adjuster and claim reviewer on the correct documentation requirements to be included in a claim file to support losses. The AIP must complete the required additional training and respond to RMA with documentation supporting the completion of the training and the date the training was completed by March 1, 2018.

Should you have any questions, please contact Nicole Smith Lees at (202) 260-8085.

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