U.S. Department of Agriculture
Office of Inspector General
Southwest Region
Audit Report

RISK MANAGEMENT AGENCY
REVIEW OF LARGE INSURANCE CLAIM
FOR WATERMELONS IN
SOUTH TEXAS

Report No.
05601-9-Te
SEPTEMBER 2002

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

DATE: September 30, 2002

REPLY TO
ATTN OF: 05601-9-Te

SUBJECT: Review of Large Insurance Claim for Watermelons in South Texas

TO: Ross J. Davidson, Jr.
Administrator
Risk Management Agency

ATTN: Garland Westmoreland
Deputy Administrator
for Risk Compliance

This report presents the results of the subject audit. The Risk Management Agency's response to the draft report, dated September 24, 2002, is included as exhibit G and is incorporated, along with the Office of Inspector General's (OIG) position, into the relevant sections of the report.

We have accepted management decision for Recommendation No. 6. Follow your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer/Planning and Accountability Division.

To reach management decision for Recommendations Nos. 1, 2, 3, 4, and 5, we need additional information as set forth in the sections marked "OIG Position." Please furnish the information needed to reach agreement on the management decision for these recommendations within 60 days. Please note that Departmental Regulation 1720-1 requires a management decision for all recommendations within a maximum of 6 months from the date of report issuance, and final action to be taken within 1 year of each management decision.

We appreciate the courtesies and cooperation extended to us by members of your staff during the audit.

/s/ R. D. Long
RICHARD D. LONG
Assistant Inspector General
for Audit

EXECUTIVE SUMMARY

REVIEW OF LARGE INSURANCE CLAIM FOR WATERMELONS IN SOUTH TEXAS

REPORT NO. 05601-9-Te

RESULTS IN BRIEF

This audit was initiated after concerns were raised that a producer in Hidalgo County, Texas, with a substantial crop loss claim on a watermelon crop, violated provisions of the 1999 watermelon insurance pilot program by misrepresenting his share of the crop. Concurrent audits of the program were showing indications of program abuse, particularly in South Texas. Producers there had rushed to plant fall watermelons after the Risk Management Agency (RMA) announced it would insure the crop, even though evidence existed that the crop would not grow. This producer activity, at a season when South Texas farmers normally let their land lie fallow, demonstrated that the program had created a "moral hazard", whereby producers would willfully neglect prudent management practices by planting an extremely large amount of acreage to a crop that had no more than a 10-percent chance of making it to harvest. The subject of this audit had the largest single loss claim in the program even though he used few of his own acres to grow the crop.

Our objectives were to determine if this producer reported his correct share in the 1999 watermelon crop and if his business relationship with other individuals engaging in watermelon production and crop insurance sales raised the appearance of a conflict of interest.

We found the producer misrepresented his share in a fall 1999 watermelon crop. Because of a crop rotation requirement, the producer could not use much of his own land for fall watermelons and consequently entered into written cash leases and custom farming agreements with 19 Hidalgo County landlords for over 6,600 acres. Based on these cash leases, the producer applied for and received 100 percent of over $5.5 million in insurance proceeds when the fall watermelon crops failed. However, some of the landlords told the Office of Inspector General (OIG) they also had oral agreements with the producer to share in the crop or insurance proceeds.

The common crop insurance basic provisions state that a lease containing provisions for both a minimum payment and a crop share will be considered a crop-share lease. The producer said he did not share the insurance proceeds with the landlords. He claimed the reimbursement checks to the landlords were only for the cash rent and custom farming expenses. However, based on information provided by the landlords, we concluded the producer may have shared over $2.3 million of the insurance proceeds with the landlords through excess reimbursements for custom farming expenses.

Most of the landlords leasing to the producer were not eligible to participate in the pilot program and therefore were not eligible for a share of the insurance. The producer was also not eligible for the landlords' share of the insurance because the common crop insurance basic provisions provide that insurance will attach only to the share of the person completing the application. The provisions also state that if a producer has misrepresented any material fact relating to its policy, the policy will be voided. The producer's 1999 policy in South Texas resulted in a total payment of $6,998,779 ($5,519,728 on a fall crop and $1,479,051 on a spring crop).

We also found that the co-owner of the agency that sold the producer his watermelon insurance appeared to conceal from the insurance company and from RMA that he had leased the producer 802.7 acres of his farmland. Such a business relationship would constitute a potential conflict of interest, and the co-owner of the insurance agency was aware that if his agreement with the producer were a share lease, he would have to report his crop share to the insurance company. The insurance agent's son also acted on behalf of the producer by pursuing additional land that the producer could lease and ultimately insure through the father's insurance company. As a result, all the participants in this arrangement received benefits they likely would not have received if the relationships had not existed.

- The father's insurance agency received commissions of about $140,000 from the policies on the 6,600 acres of fall watermelons. Because these acres would not normally have been planted to fall watermelons, insurance would not have been a consideration.

- The producer received over $5.5 million in insurance proceeds from losses on fall watermelon acres he would not normally work. The insurance agent would have known, based on his own arrangement with the producer, that the producer did not have a 100-percent share in the 6,600 acres of land he had leased for watermelons.

- The farm worked by the insurance agency's co-owner in partnership with his son received a total of $1,097,193 from the producer for the fall watermelon crop, the largest payment under the lease arrangements and 3 times the average payment received by the other custom farmers. Of this amount, the cash rent was $80,270 on the 802.7 acres. Based on a reasonable custom farming rate, the partnership should have been reimbursed about $120,405 for custom farming the 802.7 acres. We concluded that the excess payment of $896,518 was a share of the insurance proceeds.

Because of the size of this claim, the insurance company performed a mandatory review of the policy. The company reviewers took no exception to the handling of the policy or the claim.

During our audit, we attempted to obtain lists of farming expenses from the father/son partnership and the other 18 custom farmers who received excess reimbursements from the producer. We encountered a deficiency in the common crop insurance policy. The policy requires producers to retain records of the disposition of the crop, but it does not require evidence that the producer incurred expenses to grow the crop. Although RMA may enforce the provision requiring documentation of the disposition of the crop, it does not have the authority to require producers to retain expense documentation.

We resorted to subpoenas to obtain the expense data. Eighteen of the custom farmers indicated that they did not have copies of their expenses. The one custom farmer who did not respond to the subpoena is currently being sought by the U.S. Attorney's office.

KEY RECOMMENDATIONS

We recommend that RMA seek an Office of the General Counsel (OGC) opinion to determine if the producer misrepresented his share in the insured watermelon crop and, as a result, violated the common crop insurance policy provisions. If an adverse determination is made, the contract should be considered void, and RMA should collect the $6,998,779 that was paid to the producer for crop year 1999 losses.

We also recommend that RMA determine whether the business relationship of the co-owner of the insurance agency to the producer for the 1999 fall watermelon crop constituted a conflict of interest. If an adverse determination is rendered, RMA should take appropriate action against the producer, the insurance agent, the agent's son, and the insurance agency, up to and including any legal sanction or debarment against these individuals. RMA should also issue a manager's bulletin to all insurance companies clarifying business relationships and other

potential conflicts of interests involving insurance agents, loss adjustors, and producers that must be disclosed or reported to the insurance companies.

Finally, RMA needs to add a provision to the common crop insurance policy requiring insured producers to maintain and provide upon request, complete records for expenses associated with growing the insured crop.

AGENCY RESPONSE

RMA concurred with our recommendations and provided proposed actions. RMA has requested an OGC opinion to determine whether the producer misrepresented his share of the insured crop. The RMA Southern Regional Compliance Office (SRCO) will review the OGC opinion, documents from the reinsured company, and OIG audit workpapers to determine the appropriate action(s) to be taken. SRCO will also validate OIG findings and determine whether the business relationship of the co-owner of the insurance agency and the producer constituted a conflict of interest and determine the appropriate action(s). RMA will also draft a manager's bulletin to require crop insurance agents to disclose any business relationship, outside of the crop insurance agent-insured relationship, with a person or entity that they insure. In addition, RMA will add a provision to the common crop insurance policy requiring insured producers to maintain and provide upon request, complete records for expenses associated with growing the insured crop. (See exhibit G for RMA's complete response.)

OIG POSITION

We agree with the actions proposed by RMA to address the recommendations and have accepted the management decision for Recommendation No. 6. However, to reach management decisions for the other recommendations, we will need further documentation showing the results of determinations by OGC and SRCO and final dates for implemented changes to the common crop insurance policy. (See the "OIG Position" sections of the report for details.)

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INTRODUCTION

BACKGROUND

The Federal Agriculture Improvement and Reform Act of 1996, authorized the RMA to handle the day-to-day operations of the Federal crop insurance program, administered by the Federal Crop Insurance Corporation (FCIC).

The Federal Crop Insurance Act of 1980 contains provisions for expanding crop insurance to new crops and to provide coverage in most counties throughout the United States. RMA routinely develops, implements, and monitors pilot programs for new crops. Most new programs are developed at the request of farmers, following an in-depth study to determine if an actuarially sound program can be created. The new programs are tested on a pilot basis in selected counties to allow RMA to gain insurance experience and test the programs' components.

In August 1998, the FCIC Board of Directors approved the pilot program for insuring watermelon crops for the 1999 through 2001 crop years in 15 watermelon counties in 7 States. The pilot program was developed to explore the feasibility of providing insurance protection on crops that were previously covered by the noninsured assistance program or by ad hoc disaster program payments, administered by the Farm Service Agency (FSA).

Concurrent OIG audit work has disclosed cases of abuse of the pilot program. Because controls were not properly exercised over the development of the pilot program, the program, as designed, created a "moral hazard"—an incentive for producers to forgo prudent farming practices for guaranteed indemnities. USDA's Economic Research Service warned against such a moral hazard in its 1994 feasibility study of watermelons. An indication that such a hazard was present in the 1999 pilot program in South Texas was the upsurge of acres devoted to fall watermelons—from about 1,000 pre-1999 acres to about 27,000 acres enrolled for insurance protection.

One OIG review of the largest watermelon claims in the 3 South Texas counties participating in the program (Audit Report No. 05601-7-Te) found that 3 of the 11 producers reviewed did not meet eligibility requirements. We requested that RMA make a determination of the producers' eligibility and, if necessary, collect $1.5 million in indemnities paid to them. Other reviews are being conducted by OIG and RMA's special investigation unit

in the State of Florida concerning alleged fraudulent acts perpetrated by insurance agents and producers in the pilot program.

This audit focused on a producer in Hidalgo County, Texas. The producer claimed a 100-percent crop share on 6,607 acres of fall watermelons, filed a claim on these acres, and received a $5,519,728 indemnity payment. This producer also had a spring watermelon claim on 788.8 acres and received $1,479,051. The producer averaged approximately 886 acres of spring watermelon production from 1995 through 1998 but did not have a history of fall watermelon production in Hidalgo County. In order to grow 6,607 acres of fall watermelons, the producer had individual B actively pursue landowners to lease their land and recruit them to custom farm the fall watermelon crop.

The producer entered into cash lease agreements with 19 landlords to lease the 6,607 acres at $100 per acre. The cash lease agreement required the producer to pay $100 per acre to the landlord on termination of the lease. The term was for 4 months. The commencement date was August 10, 1999, and the termination date was November 10, 1999, or upon final harvest of the crop or termination of the crop, whichever was later.

A cash lease is a lease for land that is rented for cash, a fixed commodity payment, or any consideration other than a share in the crop. A written or verbal agreement containing provisions for both a minimum payment and a crop share is considered a crop-share lease.[1] If the landlords shared in the profit from the crop proceeds or crop insurance proceeds in addition to the cash lease payment, then the producer would only have been entitled to insure his share of the crop. According to the loss adjustment manual, the written terms of the producer's lease would constitute a 100-percent share in the 1999 fall watermelon crop.[2]

The producer also entered into custom farming agreements with the landlords (custom farmers) to grow the fall watermelon crop on the leased acres. The custom farming agreement for the 1999 crop year between the custom farmers and the producer required the producer to provide the seed while the custom farmers were to provide all other necessary equipment and labor to grow the watermelon crop, including all costs of planting, raising, cultivating, and harvesting the crop. The custom farmers were also required to maintain adequate records of all expenses related to farming the property and provide producer A with a copy. In exchange for growing the watermelon crop, the custom farmers received an amount mutually agreed upon after the producer received settlement on the crop.

[1] 1999 Loss Adjustment Manual (FCIC-25010), section 14 B(1)(2).
[2] 1999 Loss Adjustment Manual (FCIC –25010), section 14 B(1).

During the course of our audit, we tried to obtain copies of the custom farmers' records of expenses for the watermelon crop. We issued subpoenas to all 19 of the custom farmers as well as the producer. The producer and 3 of the custom farmers indicated that they did not have any records, and another 15 of the farmers signed affidavits to the same effect. We received no response from the 19th farmer. Enforcement of the subpoena for this custom farmer has been referred to the U.S. Attorney's Office in the U.S. District Court for the Southern District of Texas. Any information obtained through the referral that results in additional findings will be reported at a subsequent date.

In September 1999, RMA officials suspended the watermelon pilot program. In a September 13, 1999, notice to all reinsured companies and RMA field offices, the Administrator stated that RMA had received adverse comments about the terms and coverage of the program. Producers, packers, processors, members of watermelon marketing boards, and individuals from the insurance industry generally voiced concerns that the program had caused increased acreage of watermelons in 1999 and resulted in declining market prices. Based upon these complaints, RMA officials believed the watermelon pilot program needed to be reworked to make it a more market-neutral product.

OBJECTIVES

The objectives of our audit were to determine whether a producer in South Texas with a substantial crop loss claim on a watermelon crop violated provisions of the 1999 watermelon insurance pilot program by misrepresenting his share of the crop and by entering into a business relationship that may constitute a conflict of interest.

SCOPE

This audit was initiated based upon an OIG review conducted during a prior audit (Audit Report No. 05601-7-Te, "Watermelon Claims in South Texas"). During these reviews, concerns were raised that one producer in Hidalgo County may have incorrectly reported his insured share of 6,607 acres of 1999 fall watermelons and received crop insurance indemnity payments totaling $5,519,728. Concerns were also raised that the business relationship between this producer and the insurance agency owner who sold him the crop policy may have constituted a conflict of interest.

This producer also received an indemnity payment of $1,479,051 on his 1999 spring watermelon claim for a total payment of $6,998,779 on his 1999 policy in South Texas.

For the 1999 watermelon insurance pilot program, insurers sold 386 policies with a total liability of $63.7 million in the 15 counties of the 7 States that participated in the program. The Government paid $47.8 million in indemnities on 241 of these polices. In Texas, the Government paid $32.5 million in indemnities on 79 policies in the 3 approved counties (Duval, Frio, and Hidalgo). The subject producer of this audit had the largest fall claim and the highest payments (21.5 percent of total payments) for a watermelon insurance policy in South Texas.

Audit fieldwork was conducted from January 2001 through August 2001.

This audit was conducted in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, the audit included such tests of program and accounting records as considered necessary to meet the audit objective.

METHODOLOGY

To verify the producer's share in the 1999 fall watermelon crop, we reviewed documentation in the loss adjustment claim file maintained by the insurance company. This file contained actual production history reviews, production and yield reports, correspondence letters with the insured, proof of loss statements, high dollar loss reviews, appraisal worksheets, applications, production records, crop insurance loss claim adjuster (loss adjuster) reports, land acreage certifications, schedule of insurance documents, and other miscellaneous documents.

We also performed the following reviews:

- We obtained and reviewed copies of land leases, custom farming agreements, and cancelled checks for such arrangements from the producer.

- We requested copies of custom farming expenses submitted by the landlords (custom farmers) to the producer for reimbursement. These documents, which would further verify the insured shares for both the producer and the 19 custom farmers, were not provided. Only seven custom farmers provided some documentation (chemical, fertilizer, seed, or water records) for custom farming expenses incurred for the fall 1999 watermelon crop, but none of the documents included all the expenses necessary for growing the 1999 fall crop. One custom farmer did not respond to our request. As noted, he is being sought by the U.S. Attorney.

- We conducted interviews with the custom farmers and made written requests to the producer to obtain details of the land lease and custom farming agreement.

- We interviewed personnel with RMA's SRCO to determine crop insurance requirements for leases.

- We reviewed the report of acreage (form FSA-578) along with aerial slides and county maps, and we interviewed FSA personnel to verify the insured acres for the producer's fall claim at the Hidalgo County FSA Office. In addition, we reviewed FSA crop disaster program files for custom farmers that received crop disaster program payments to review acreage and expense documentation.

To review the potential conflict of interest, we used most of the same documentation listed above. We also interviewed insurance company representatives to determine commissions earned for the producer's policy.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	THE PRODUCER VIOLATED INSURANCE POLICY PROVISIONS THROUGH INTENTIONAL MISREPRESENTATION

FINDING NO. 1

PRODUCER MISREPRESENTED HIS SHARE OF THE CROP

A large watermelon producer misrepresented his share in a 1999 fall watermelon crop as a 100-percent share in order to receive 100 percent of the crop insurance indemnity payments when the crop failed. Although the producer entered into written cash leases of land and custom farming agreements with 19 landlords, we found evidence that he had also entered into oral agreements with the same landlords which allowed the landlords, who were not eligible to participate in the pilot program, to share in the crop insurance proceeds. Such oral agreements constitute crop-share leases rather than cash leases and reduce the producer's share of the insured crop accordingly. A strong incentive existed for the landlords to participate in the program through the producer because of the program's guaranteed payments for crop failure on a crop that normally would not survive. Ultimately, the custom farming payments to the producers were more than double the normal cost of any work performed farming the watermelons (in one case as high as 8.4 times the normal cost). By including fall watermelons in its pilot program, RMA created a "moral hazard," a condition under which farmers would neglect prudent farming practices by planting an extremely large amount of acreage to a crop that had no more than a 10-percent chance of making it to harvest.

As a result of the producer's misrepresentations, the producer was not in compliance with contract terms or with the intent of the crop insurance program. We therefore questioned the total payment of $6,998,779 ($5,519,728 for the fall crop and $1,479,051 for the spring crop) made on the producer's 1999 policy in South Texas.

The common crop insurance basic provisions provide that insurance will attach only to the share of the person completing the application and will not extend to any other person having a share in the crop unless his/her share is clearly stated on the application. Additionally, these provisions provide that acreage rented for a percentage of the crop, or a lease containing

provisions for both a minimum payment and a crop share, will be considered a share lease.[3]

The common crop insurance basic provisions further provide that if a producer or anyone assisting them has intentionally concealed or misrepresented any material fact relating to his or her policy, the policy will be voided.[4]

The producer leased 6,607 acres of land from 19 landowners in Hidalgo County and insured the acres for a fall crop of watermelons under the watermelon pilot program. The producer claimed a 100-percent share of the crop, and when the crop failed due to a viral disease, the producer received $5,519,728 in payments, or 100 percent of the indemnity. In accordance with the lease agreements between the producer and the custom farmers, the producer paid the custom farmers an amount that was to represent the agreed-upon rent ($100 per acre) and the costs the custom farmers incurred farming the crop. Each farmer was paid with one check made for a single amount.

The producer told us through his attorney that he solely owned the entire fall watermelon crop on the 6,607 acres and that he paid for the land leases as well as the crop expenses.

An interview with one custom farmer revealed that some farmers had agreements with the producer to share in the crop proceeds or crop insurance. Custom farmer B stated that in addition to the written agreements to cash lease the land and custom farm the crop for the producer, he also had an oral agreement to split the profit from the watermelon crop after expenses. Initially, the agreement was to split the profit from the crop, but because there were no profits, the crop insurance proceeds were split instead.

Based on the information provided by custom farmer B, we questioned whether the leases were in fact cash leases, and whether the producer had a 100-percent insurable share in the fall watermelon crop. In order to determine if the producer shared the crop insurance proceeds with the custom farmers, we needed to compare the amount the producer paid the custom farmers to the amount stipulated in the leases and the farming agreements ($100-per-acre cash payment plus the farmers' costs of custom farming the acreage). To perform such a comparison, we first needed to determine the farmers' costs.

[3] Common Crop Insurance Policy (99-BR), section 10(a)(c).
[4] Common Crop Insurance Policy (99-BR), section 27(a).

Documentation of Farmers' Costs Was Unavailable

We requested the copies of the custom farming expenses turned in to the producer for payment by each custom farmer. The only documents the producer had to support the payment to each custom farmer was a copy of the land lease and custom farming agreement along with the cancelled check. The producer could not provide a listing of expenses from the custom farmers or any other detail of how each custom farming payment was computed.

The producer stated through his attorney that individual B acted for him in obtaining copies of the expenses incurred by the custom farmers. He reviewed the documentation and wrote checks to the custom farmers based on the expenses reported. However, he did not take possession of the custom farming expense listings and consequently did not have a copy of them.

Individual B stated through his attorney that he did not retain the custom farming expense listings after the producer wrote the checks to the custom farmers.

The custom farming agreement required each individual farmer to maintain a copy of all expenses incurred on the fall watermelon crop. However, 18 of the 19 custom farmers indicated that they did not have copies of the custom farming expenses that were provided to the producer for payment. A response was not received from the remaining custom farmer. Only seven of the custom farmers included some receipts for water, chemicals, or fertilizer in their response, but they did not include expenses for planting, raising, or cultivating the watermelon crop.

At our request, RMA asked the producer's insurance company in writing for the documentation the producer used to support his 100-percent share in the fall 1999 watermelon crop. RMA cited the common crop insurance policy, which gives RMA access to insured crop records and requires the insured to retain them for 3 years.[5] (See Finding No. 2 for issues concerning the crop insurance policy.) The producer's insurance company tried to obtain the custom farming expense documentation but was unsuccessful. The producer responded to the insurance company through his attorney that the producer had provided everything that could be provided to OIG.

[5] Common Crop Insurance Policy (99-BR), section 21(b)(c).

OIG Calculated the Reasonable Costs of Production

In the absence of documented expenses, we calculated a reasonable rate for watermelon production costs. We reviewed crop profiles on watermelons prepared by the Texas Agricultural Extension Service. Using this profile, we estimated that it would cost approximately $1,218 per acre to grow and harvest an irrigated watermelon crop. This included a reasonable rate of return for the labor invested by the farmer in planting, maintaining, and harvesting the crop. However, in South Texas the crops failed within a month of planting and no watermelons were harvested.[6] The producer stated through his attorney that since the melons were planted in August, and the loss occurred for most of the farmers within a month of planting, the labor, chemicals, and related care would not have been as costly as if the crop matured. We concluded that the custom farming expenses would not have been as high as normal and would have involved only a few select costs:

Direct farming expenses. Direct expenses would have been for fertilizer and chemicals only. There would have been no seed expense for the farmers because the producer provided the seeds.

Variable farming expenses. Variable expenses would have included labor and equipment for planting, cultivating, applying chemicals, and watering. Of the five custom farmers who submitted irrigation records, none had more than $858 in water expenses for the fall watermelon crop. The loss adjuster stated in his report that many fields were never irrigated due to excess rainfall. Many were irrigated once, and a very few were irrigated twice. In addition, there was no drip-tape for irrigation, no plastic mulch for planting, and no harvesting expense.

Based on the facts and data presented by the Texas Agricultural Extension Service, we determined that a reasonable average cost to tend watermelons for the time the crop was in the ground was $150 per acre. (See exhibit E.) This figure includes a reasonable rate of return for the work performed and is supported by three sources.

- Custom farmer B stated that his watermelon expenses included herbicides and water. He stated that he performed land preparation, planting, spraying, cultivating, and shredding with his equipment as part of the custom farming agreement. He did not keep a copy of the custom farming expenses that were provided to individual B. He estimated that the expenses were around $125 to $130 per acre but did not believe that

[6] The production worksheets prepared by the loss adjuster showed no harvested production. These worksheets included limited appraised production because appraisals were only performed on 491.4 (7.4 percent) of the total 6,607 acres.

they exceeded $150 per acre. He stated that he acted as the agent for his father (custom farmer C), as well as for his brother-in-law (custom farmer D), who both had similar arrangements with the producer and likely incurred the same expenses.

- Although custom farmer F did not provide OIG with the requested listing of his 1999 fall watermelon farming expenses, he did submit such a listing to the Hidalgo County FSA Office. Custom farmer F farmed a total of 256 acres, 10.3 acres of which he farmed for himself, to gain the watermelon experience necessary to participate in the pilot program the following year. The custom farming expense listing for the 256 acres was turned into the FSA County Office so that the farmer could obtain crop disaster payments on his 10.3 acres. The listing showed that he incurred costs of $120 per acre. (See summary of expenses turned into the FSA County Office at exhibit D.)

  Custom farmer F claimed he had some additional expenses, but he could not provide us with any details of these expenses. We noted that the expense list that showed his costs to be $120 per acre was submitted to the Hidalgo County Office after the loss adjuster had completed the appraisal worksheet and after the farmer received payment for his custom farming expenses from the producer.

- We obtained data on the crop expenses incurred by the producers with the next two largest irrigated fall watermelon claims. One producer that farmed the crop himself on 4,422.9 acres had a comparable average crop cost of $158 per acre. The other producer who had someone else custom farm his 3,197.5 acres had a comparable crop cost of $122 per acre. (Both of these producers incurred a large amount of irrigation expenses because they were in a different county, which did not get much rain during the fall watermelon season. Therefore, we adjusted their irrigation expenses to reflect irrigating the crop only one time.) (See comparison of crop expenses in exhibit F.)

As a result of this information, we concluded that it was reasonable to assign an average crop expense of $150 per acre to the custom farmers.

Reasonable Production Costs Were Less Than Actual Payments

We compared the actual payments received by the farmers to the amounts stipulated in the leases and the custom farming agreements. Using the $150 average cost per acre, we determined that each custom farmer, except for custom farmer A, would have received an excess payment per acre of $189 to $303. (See exhibit C.) Custom farmer A, which was a partnership composed of the co-owner of the insurance agency that sold the

producer his policy and the co-owner's son, would have received an excess payment of $1,117 per acre. (See Finding No. 3.)

In some sample cases, such as custom farmer B, the excess payments were based on statements made by the custom farmers. In the case of custom farmer F, the excess was based on available documentation.

- Custom farmer B, who acknowledged costs of less than $150 per acre, stated that he received a check for $200,320 from the producer as payment under the land lease and custom farming agreement. A total of $42,340 was for the cash lease of the land. The remaining $157,980 was for the custom farming expenses incurred on 423.4 acres and his share of the profit. He stated that at $150 per acre, he made a profit of $223 per acre.

- Since custom farmer B's father and brother-in-law (custom farmers C and D) had the same arrangement as custom farmer B, we used the maximum estimate of $150 per acre. Custom farmer C was paid $75,237 under the cash land lease and custom farming agreements with the producer for 169 acres of watermelons. We calculated that, with costs of $150 per acre, he would have had an excess payment of $32,987. Custom farmer D was paid $108,310 as final settlement for the lease and custom farming of 247 acres of watermelons. We calculated that with costs of $150 per acre, he would have received an excess payment of approximately $46,560.

- Custom farmer E stated that he only had a few watermelon vines come up and did not make a crop. He did not have any water expenses because too much rainfall destroyed the crop before the first irrigation. Custom farmer E stated that the only other expenses he had were fertilizer and herbicide. He stated that he told individual B to just forget it since he did not make a crop, but individual B insisted that the producer had an agreement with farmer E. Custom farmer E received $48,948 for final settlement on 111 acres. The cash lease amount was $11,100. We calculated that with costs of $150 per acre, farmer E would have received an excess payment of approximately $21,198.

- Custom farmer F stated that he received $123,644 for payment under his agreement with the producer. A total of $24,570 was for the cash lease of the land while the remaining $99,074 ($403 per acre) was for the custom farming expenses he performed. Custom farmer F stated that he did not believe he received a share of the profit from the crop but that he did not know how the $99,074 figure was computed. As noted earlier, documentation in the Hidalgo County FSA Office showed that custom farmer F's expenses were $120 per acre. Applying this

figure to the 245.7 acres farmed by farmer F, we calculated that the farmer's total expenses were $29,509. This would have resulted in an excess payment to custom farmer F of $69,565.

We calculated that the 19 custom farmers received a total of $2,328,489 in excess of the rent and farming expenses agreed to in the lease and the farming agreements. We concluded that this amount, which is 42 percent of the insurance proceeds, represented the custom farmers' share of those proceeds. We also noted that this percentage is more indicative of a crop share than a cost reimbursement and is even higher than some crop shares experienced with other crops in the area (e.g., cotton and corn, which normally see a landlord crop share of only 25 percent and 33.3 percent, respectively).

Custom Farmers Were Ineligible for Insurance

In order to insure a crop in the pilot program, regulations require that the insured crop must be grown by a person who, in at least 1 of the 3 previous crop years, either grew watermelons for commercial sale or participated in managing a watermelon farming operation.[7]

Custom farmers B and F provided statements that they did not meet this insured crop experience requirement. In fact, these custom farmers, along with custom farmers C, D, H, and L, actually farmed some watermelon acres for themselves during the fall of 1999 and subsequently collected FSA crop disaster program payments on this acreage. Custom farmers B and F both stated that this was done so that they could establish a watermelon history for participation in the pilot program during the next crop year.

An FSA representative confirmed that these arrangements existed during the 1999 crop year for watermelons. He stated that a review of FSA records indicated that several landowners that rented land to the producer did not have a watermelon history to participate in the pilot program. He further stated that the landowners usually kept one field for themselves, so that they could develop a history for the next crop year. For example, if a producer with no watermelon history had eight fields, he would lease seven of them to a producer with history and keep one field so that he could have a history next year.

We believe that the custom farmers entered into a share-lease relationship with the producer because they were not eligible to participate in the pilot program themselves. However, under a share lease, the producer would

[7] 1999 Watermelon Pilot Crop Provisions, section 7(A)4.

only have been entitled to insure his share of the crop while the remaining share of the crop would not have been insurable.

We concluded that the producer misrepresented his shares of the crops when he insured the acreage he leased from the 19 custom farmers. The clearest evidence for this is the case for custom farmers B, C, and D. As a result, the producer has violated the contract terms and intent of the crop insurance program and received $5,519,728 for the loss of a crop for which he did not have a 100-percent share.

As noted earlier, common crop insurance provisions provide that if a producer intentionally misrepresents any material fact about the policy, the policy will be voided. Because the producer's policy covered both spring and fall plantings, we question both the producer's spring indemnities ($1,479,051) and his fall indemnities ($5,519,728).

RECOMMENDATION NO. 1

Determine, by seeking an OGC opinion, whether the producer misrepresented his share of the insured crop and, as a result, violated the common crop insurance policy provisions.

RMA Response

RMA concurs with the recommendation. A request for OGC opinion was made on September 16, 2002.

OIG Position

We agree with the proposed action. To reach management decision, we need a copy of the OGC opinion.

RECOMMENDATION NO. 2

If OGC determines that the producer misrepresented his share of the crop, void the entire policy and pursue collection from the insurance provider the questioned indemnities paid out under the policy to the producer.

RMA Response

RMA conditionally concurs with the recommendation. The RMA's SRCO has requested the policy documents from the reinsured company, and received the OIG audit workpapers. Once the OGC opinion is received, SRCO will review and validate the OIG findings and recommendation and

determine the appropriate action(s). RMA will notify OIG of its determination(s).

OIG Position

We agree with the proposed action. To reach management decision, we need a copy of the statement of finding issued to the insurance company by SRCO based on the OGC opinion along with documentation showing the amounts owed the Government have been collected or set up as accounts receivable. If an adverse decision is not rendered, we need documentation supporting such a decision.

FINDING NO. 2
INSURANCE POLICY PROVISIONS NEED STRENGTHENING

RMA's common crop insurance policy does not contain provisions explicit enough to ensure that producers retain all documents necessary to support their claimed share of the insurable crop. The policy requires documentation of the disposition of the crop, but it does not require evidence that the policyholder incurred expenses to grow the crop. Although RMA may cancel the policy or the indemnity of a policyholder who violates the documentation provisions, it cannot use these enforcement measures in cases like those encountered during this audit, where documentation was not in evidence to show that the lease was indeed a cash lease and not a share lease.

During our audit, RMA's SRCO made a written request to the producer's insurance company for documentation to support the producer's claim of a 100-percent share in the fall 1999 watermelon crop. For purposes of determining the producer's interest in the 1999 fall watermelon crop, the region requested copies of invoices and detailed expense listings to include settlement sheets and other documentation used to prepare checks to the custom farmers for custom farming expenses related to the fall 1999 watermelon crop.

The request letter cited the common crop insurance policy which allows RMA access to insured crop records. Specifically, for the 3 years after the end of the crop year, the insured must retain, and provide upon request, complete records of the harvesting, storage, shipment, sale, or other disposition of all of the insured crop produced on each unit. This requirement also applies to the records used to establish the basis for the production report for each unit. The insured must also provide, upon request, separate records showing the same information for production from any acreage not insured.

The record-retention period may be extended beyond 3 years, if RMA notifies the policyholders of such an extension in writing. If the policyholders fail to keep these records, RMA may take any one of four actions: (1) cancel the policy, (2) assign production itself to the units, (3) combine optional units, or (4) determine that no indemnity is due. [8]

The policy provision is silent in regards to records for production expenses associated with growing the insured crop. However, this information would be needed to establish that proper management practices were followed and the share of the insured was correct.

Responding to RMA's request, the producer's insurance company tried to obtain the requested custom farming expense documentation to support the producer's interest in the 1999 fall watermelon crop. The producer responded through his attorney that he had previously provided everything that could be provided to OIG, including copies of checks that the producer gave to individual farmers, seed bills, chemical bills, labor expenses, as well as water expenses. However, as previously stated, complete custom farming expenses incurred by each custom farmer, to include chemical bills, fertilizer expenses, labor expenses, irrigation receipts, and other custom farming expenses for the producer's fall 1999 watermelon crop, were not provided by the producer or any of the custom farmers. RMA found that its enforcement powers under the crop insurance policy did not extend to these documents.

Insofar as farming expenses are critical to determining management practices and crop shares, we concluded that RMA needs to modify the common crop insurance policy to state that complete records for expenses associated with growing the crop are among the documents required to be retained.

RECOMMENDATION NO. 3

Add to section 21 of the common crop insurance policy a paragraph that will require the insured to maintain complete records for any expenses associated with growing the crop and that will incorporate the same maintenance and penalty requirements already established for production records.

RMA Response

RMA concurs with the recommendations. Section 21 of the Basic Provisions Policy Proposed Rule contains language requiring that for

[8] Common Crop Insurance Policy (99-BR), section 21(b)(c).

3 years after the end of the crop year, the insured must retain, and provide upon request, complete records of the planting, replanting, inputs, production, harvesting, and disposition of the insured crop on each unit. The proposed rule also makes the penalty for failure to maintain records for expenses associated with the growing the crop the same as the penalty for failure to provide production records.

The proposed rule was published in the Federal Register on September 18, 2002, with the comment period ending October 18, 2002. The final rule may be effective for either the spring 2003 crop year or the 2004 crop year. RMA believes the language in section 21 of the Basic Provisions addresses Recommendation No. 3.

OIG Position

We agree with the proposed action. To reach management decision, we need documentation of the final rule (showing the effective date of the final rule) when published in the Federal Register containing language requiring the insured to retain and provide upon request, complete records of the planting, replanting, inputs, production, harvesting, and disposition of the insured crop on each unit with the proposed penalty the same as the failure to provide production records.

CHAPTER 2	THE CO-OWNER OF THE INSURANCE AGENCY APPEARED TO BE CONCEALING A POTENTIAL CONFLICT OF INTEREST ARISING FROM A FARMING BUSINESS RELATIONSHIP WITH THE PRODUCER

FINDING NO. 3

The co-owner of the agency that sold the producer his RMA watermelon insurance policy had entered into a farming business relationship with the producer that he appeared to conceal from both the insurance company and RMA and that netted his farming business over $1 million, 3 times the average payment received by the other custom farmers growing watermelons for the producer. Individual A was a co-owner of the insurance agency and the father of individual B, with whom he had formed a farming partnership that had a lease and custom farming agreement with the producer for fall watermelons on 802.7 acres. In turn, individual B, acting on behalf of the producer, actively pursued additional land for the producer to lease for fall 1999 watermelon crops that were insured through the father's insurance agency. A subsequent review of the policy by the insurance company reported no errors or omissions. As a result, the producer received crop-share coverage he was not entitled to, the insurance agency's commissions increased, and individuals A and B received insurance proceeds for which they were not eligible. In effect, all the participants in this arrangement received benefits they would not have received if their relationships had been otherwise.

The insurance agency sold crop insurance coverage to the producer, who claimed 100-percent interest in the crop. The coverage was for 6,607 acres of fall watermelon crops in Hidalgo County, most of which were leased from landlords who did not qualify for watermelon crop insurance. Among the landlords were the co-owner of the insurance agency, individual A, and his son, individual B. Individual B arranged for the leasing of the land as well as the hiring of the landlords to custom farm the watermelon crops on their own land. Before any crop could mature, the producer lost the crop, filed a claim, and was paid an indemnity of about $5.5 million.

Having entered an implied agreement with the producer to custom farm his watermelon crop in exchange for a share of the crop insurance proceeds (see Finding No. 1), individual A was aware: (1) that the producer did not have a 100-percent interest in the crop, (2) that if his agreement with the producer constituted a share lease, he would have to

report his crop share to the insurance company, and (3) that the policy his agency sold the producer naming the producer as a 100-percent owner of the crop essentially enabled others to participate in the pilot program even though they were not eligible. Nevertheless, he sold the producer a policy for 100-percent coverage. As a result of individual B's effort to recruit land for insurance coverage, individual A's insurance agency earned an estimated $140,000 in sales commissions. As a result of the agreement individuals A and B had with the producer to lease and farm 802.7 acres of watermelons for him, they received program benefits amounting to almost $900,000 that they were not entitled to.

Manual 14, Guidelines and Expectations for Delivery of the Federal Crop Insurance Program, establishes minimum requirements concerning quality control review procedures and performance standards for insurance providers.[9] The handbook requires that mandatory reviews be conducted when crop claims of $100,000 or greater are paid on a policy.[10] To guard against conflicts of interest, the handbook also requires that mandatory reviews be conducted when crop claims are made by individuals directly associated with the Federal crop insurance program.[11] However, the handbook does not address a situation in which an insurance agent leases land to a policyholder or where a close relative of the insurance agent makes it possible for the policyholder to buy a large-dollar insurance policy from the agency co-owned by the agent.

In this case, the claim amount exceeded the $100,000 threshold for a mandatory review. The insurance company performed such a review and took no exception to the policy. Because the lease was nominally a cash lease, the co-owner of the insurance agency was not required to alert the insurance company to his business relationship with the producer or to his parental relationship with the individual enlisting custom farmers to help enlarge the acreage insured. If the lease had been properly categorized as a crop-share lease, the agency co-owner would have had to report his name and social security number to the insurance company and to identify himself as having a "substantial beneficial interest" in the farming partnership with his son.

a. Relationships Benefited the Insurance Agency

The son of the co-owner of the insurance agency that sold insurance to the producer assisted the producer in contacting and recruiting

[9] Manual 14, paragraph 1, Guidelines and Expectations for Delivery of the Federal Crop Insurance Program, September 1997.
[10] Manual 14, paragraph 7C(5)(c), Guidelines and Expectations for Delivery of the Federal Crop Insurance Program, September 1997.
[11] Manual 14, paragraph 7C(5)(b), Guidelines and Expectations for Delivery of the Federal Crop Insurance Program, September 1997.

landlords. He arranged for the landlords to lease to the producer large numbers of acres in Hidalgo County and to custom farm fall watermelons for the producer on the leased land. There appeared to be no written agreement between individual B and the producer. Landlords approached by individual B were themselves unaware of his business relationship with the producer and assumed they were entering into an agreement with individual B. They did not see or speak with the producer either during the farming operation or when they received payment for the failed crop.

One landlord (custom farmer B) who did not qualify for watermelon crop insurance because he did not have the experience required by RMA to get coverage, told us that he dealt only with individual B and never met the producer. This landlord stated that he was led to believe that he would receive a share of the crop insurance proceeds if the crop failed and insurance claims were paid.

Experts in the Hidalgo area told OIG that not many acres of fall watermelons were ever grown in South Texas because the crop had a 90-percent failure rate due to insects, diseases, and the weather. Normally, custom farmer B, as well as most South Texas farmers, would have let most of their land remain fallow during the fall. (The problem of growing fall watermelons in South Texas was reported in OIG Audit Report No. 05601-8-Te, "Viability of Fall Watermelons in South Texas and Their Inclusion in the 1999 Watermelon Insurance Pilot Program.") The producer's arrangement allowed the farmers to receive cash payments for renting out their land and generate income in the fall. In essence, farmers benefited from the pilot program without having to participate in it.

Another landlord (custom farmer F) also stated that individual B actively solicited him to rent his land to the producer for the purpose of growing fall watermelons. He said that he thought he had rented his land to individual B and custom farmed the watermelon crop for him rather than the producer, whom he too had never met.

Individual B's actions—his solicitation of land from landlords who were not qualified for watermelon crop insurance, his hiring of the landlords to custom farm watermelon crops on their own land, and his indication to the landlords that they would share in the crop insurance claim proceeds with the producer—were all done in order to increase the availability of land that could be planted and insured. As noted, the insurance was purchased from individual B's father's insurance agency, which gained about $140,000 in sales commissions.

b. Relationships Benefited the Farming Partnership of Individual A and Individual B

Individuals A and B (father and son) were also in a farming partnership that rented about 800 acres of land to the producer for the purpose of growing 1999 fall watermelons. This partnership (custom farmer A) also custom farmed the watermelon crop and was paid a rate of about $1,270 per acre, a rate that was over 3 times more per acre than costs reportedly incurred by other custom farmers of watermelon crops in Hidalgo County.

Other custom farmers experienced expenses that were compatible with what we calculated to be a reasonable amount to tend a crop that was only 1 month in the ground. As noted in Finding No. 1 of this report, custom farmer B stated that as a custom farmer for the producer, he spent no more than $150 per acre using his own equipment to prepare, plant, spray, cultivate, and return his land back to its original state (after the watermelon crop was lost). Another custom farmer for the producer, custom farmer F, spent about $120 an acre performing these same services on land he rented to the producer.

In contrast, custom farmer A was paid $1,270 per acre. This farmer received a total of $1,097,193 in rent payments and reimbursement of farming expenses for 802.7 acres. The cash rent totaled $80,270, leaving $1,016,923 for custom farming expenses. Using the farming rate of $150 per acre, we would expect custom farming reimbursements for this partnership to be about $120,405. However, as a result of the arrangements between the co-owner of the insurance agency and the producer, the co-owner's partnership received an additional benefit of almost $900,000.

We believe these arrangements among individuals A, B, and the producer constitute, at a minimum, the appearance of a conflict of interest. We also believe that individual A's behavior suggests that the individual was concealing his true relationship with the producer because he understood that that relationship likely constituted a conflict of interest and would have triggered additional mandatory reviews by the insurance company.

RECOMMENDATION NO. 4

Determine whether the interaction of the insurance agency, individuals A and B, and the producer for the 1999 fall watermelon crop insurance proceeds constituted a conflict of interest.

RMA Response

RMA conditionally concurs with the recommendation. RMA's SRCO has requested the policy documents from the reinsured company, and received the OIG audit workpapers. SRCO will review and validate the OIG findings and recommendations and determine the appropriate action(s). RMA will notify OIG of its determination(s).

OIG Position

We agree with the proposed action. To reach management decision we need a copy of the decision by SRCO of whether the interaction of the insurance agency, individuals A and B, and the producer constituted a conflict of interest.

RECOMMENDATION NO. 5

If an adverse determination is made for Recommendation No. 4, take appropriate action against the insurance agency, his son, and the producer for their participation in the conflict of interest situation, up to and including any legal sanction or debarment.

RMA Response

RMA conditionally concurs with the recommendation. RMA's SRCO has requested the policy documents from the reinsured company and received the OIG audit workpapers. SRCO will review and validate the OIG findings and recommendation and determine the appropriate action(s). RMA will notify OIG of its determination(s).

OIG Position

We agree with the proposed action. To reach management decision, we need a copy of the legal sanction, debarment, or any other action to be taken against the insurance agency, his son, and the producer for their participation in the conflict-of-interest situation.

RECOMMENDATION NO. 6

Issue a manager's bulletin to all insurance companies clarifying the business relationships and other potential conflicts of interest involving insurance agents, loss adjustors, and producers that must be disclosed or reported to the companies.

RMA Response

RMA concurs with the recommendation. RMA will draft a manager's bulletin to require crop insurance agents to disclose any business relationship, outside of the crop insurance agent-insured relationship, with a person or entity that they insure. This would include the leasing of land and providing custom farming services. RMA believes this requirement is covered by current language in the Standard Reinsurance Agreement. RMA plans to complete this action by December 31, 2002.

OIG Position

We agree with the management decision. For final action, provide the Office of the Chief Financial Officer a copy of the manager's bulletin when issued.

EXHIBIT A - SUMMARY OF MONETARY RESULTS

FINDING NUMBER	RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	2	Producer Misrepresented His Insured Share	$6,998,779	Questioned Costs, Recovery Recommended
TOTAL			**$6,998,779**	

EXHIBIT B - SUMMARY OF AMOUNT RECEIVED BY CUSTOM FARMERS

	A	B	C	D	E
CUSTOM FARMER	NUMBER OF CASH LEASED ACRES	CHECK AMOUNT	AMOUNT APPLICABLE TO CASH LEASE[1]	AMOUNT APPLICABLE FOR CUSTOM FARMING[2]	AMOUNT APPLICABLE PER ACRE FOR CUSTOM FARMING[3]
A	802.7	$1,097,193	$80,270	$1,016,923	$1,267
B	423.4	200,320	42,340	157,980	373
C	169.0	75,237	16,900	58,337	345
D	247.0	108,310	24,700	83,610	339
E	111.0	48,948	11,100	37,848	341
F	245.7	123,644	24,570	99,074	403
G	99.6	46,593	9,960	36,633	368
H	514.7	269,206	51,470	217,736	423
I	1,049.9	534,772	104,990	429,782	409
J	410.2	203,257	41,020	162,237	396
K	208.0	91,412	20,800	70,612	339
L	483.8	267,361	48,380	218,981	453
M	266.0	127,825	26,600	101,225	381
N	137.4	64,833	13,740	51,093	372
O	501.5	258,400	50,150	208,250	415
P	396.1	198,002	39,610	158,392	400
Q	54.9	26,591	5,490	21,101	384
R	407.8	198,744	40,780	157,964	387
S	79.0	39,766	7,900	31,866	403
TOTAL	**6,607.7**	**$3,980,414**	**$660,770**	**$3,319,644**	

[1] The amount applicable to the cash lease was computed by multiplying the acres on the cash lease agreement (column A) by the cash lease amount per acre ($100).

[2] The amount received from custom farming was determined by subtracting the amount applicable to the cash lease (column C) from the check amount (column B).

[3] The amount received per acre for custom farming was determined by dividing the amount received from custom farming (column D) by the cash leased acres (column A).

EXHIBIT C - CALCULATION OF EXCESS PAYMENT PER ACRE

	A	B	C	D	E	F
CUSTOM FARMER	NUMBER OF CASH LEASED ACRES	AMOUNT OF CHECK	AMOUNT APPLICABLE TO CASH LEASE[1]	AMOUNT ESTIMATED FOR CUSTOM FARMING[2]	ESTIMATED EXCESS PAYMENT[3]	ESTIMATED EXCESS PAYMENT PER ACRE[4]
A	802.7	$1,097,193	$80,270	$120,405	$896,518	$1,117
B	423.4	200,320	42,340	63,510	94,470	223
C	169.0	75,237	16,900	25,350	32,987	195
D	247.0	108,310	24,700	37,050	46,560	189
E	111.0	48,948	11,100	16,650	21,198	191
F	245.7	123,644	24,570	36,855	62,219	253
G	99.6	46,593	9,960	14,940	21,693	218
H	514.7	269,206	51,470	77,205	140,531	273
I	1,049.9	534,772	104,990	157,485	272,297	259
J	410.2	203,257	41,020	61,530	100,707	246
K	208.0	91,412	20,800	31,200	39,412	189
L	483.8	267,361	48,380	72,570	146,411	303
M	266.0	127,825	26,600	39,900	61,325	231
N	137.4	64,833	13,740	20,610	30,483	222
O	501.5	258,400	50,150	75,225	133,025	265
P	396.1	198,002	39,610	59,415	98,977	250

	A	B	C	D	E	F
CUSTOM FARMER	NUMBER OF CASH LEASED ACRES	AMOUNT OF CHECK	AMOUNT APPLICABLE TO CASH LEASE[1]	AMOUNT ESTIMATED FOR CUSTOM FARMING[2]	ESTIMATED EXCESS PAYMENT[3]	ESTIMATED EXCESS PAYMENT PER ACRE[4]
Q	54.9	26,591	5,490	8,235	12,866	234
R	407.8	198,744	40,780	61,170	96,794	237
S	79.0	39,766	7,900	11,850	20,016	253
TOTAL	**6,607.7**	**$3,980,414**	**$660,770**	**$991,155**	**$2,328,489**	

[1]The amount applicable to the cash lease was computed by multiplying the acres on the cash lease agreement (column A) by the cash lease amount per acre ($100).

[2]The amount estimated for custom farming was computed by multiplying the number of acres custom farmed (column A) by $150 maximum custom farming expense per acre.

[3]The excess payment was estimated by subtracting the cash lease amount (column C) and the estimated custom farming expense (column D) from the check received from producer A (column B).

[4]The excess payment per acre was computed by dividing the total excess payment (column E) by the number of acres custom farmed (column A).

EXHIBIT D - SUMMARY OF CUSTOM FARMING EXPENSES INCURRED BY CUSTOM FARMER F

Description Of Work Performed	Amount Of Expense	Total Expense	Acreage Farmed[1]
Total Acres Custom Farmed by Farmer F			256.0
Expenses Incurred Directly By Producer F:			
Payment To Third Party To Bed & Plant Crop	$5,000.00		
Apply Curbit By Air 8/25/99	1,100.00		
Cultivate Total Rows -2 times	3,584.00		
Spray Drop On Melons	1,017.00		
Chemical	600.00		
Water for Watermelon Crop	1,004.68		
Labor	1,500.00		
Disc And Rebed To Put Land Back In Same Condition	5,888.00		
Subtotal		$19,693.68	
Expenses Owed To Third Party:			
Spray Drop	$1,024.00		
Hoeing	4,578.00		
Chemical	4,210.56		
Seed	1,240.00		
Subtotal		$11,052.56	
Total Expenses and Acreage		$30,746.24	256.0
Expense Per Acre	$120.10		
Acres Farmed For Producer A			245.7
Custom Farming Expense For Acres Farmed For Producer A		$29,508.57	
Payment From Producer A For Custom Farming		99,074.00	
Excess Payment		**$69,565.43**	

[1] Although farmer F farmed a total of 256 acres, he maintained his own interest in 10.3 acres in order to have a production history to meet the insured crop eligibility requirements for participating in the pilot program the next crop year.

EXHIBIT E - SUMMARY OF AVERAGE CROP EXPENSE FOR CUSTOM FARMERS

Crop Cost Description	Required Cost Amount[1]	Application Factor Percentage[2]	Average Crop Expense For Custom Farmers	Total For Custom Farmer F[3]
Variable Watermelon Crop Costs				
Seed[4]	60	0.00	0	5
Fertilizer[5]	32	0.50	16	0
Pesticide (herbicide, insecticides, fungicides)[5]	110	0.33	37	31
Irrigation 4 applications at $9 per app.[6]	36	0.25	9	4
Drip Tape[7]	225	0.00	0	0
Machinery Labor Cost[5]	18	1.00	18	19
Other Labor Cost[5]	65	0.50	32	24
Harvest Expense[5]	350	0.00	0	0
Plastic Mulch[7]	175	0.00	0	0
Subtotal Variable Watermelon Crop Costs	1071		112	83
Fixed Watermelon Crop Costs				
Machinery and Equipment[5]	47	0.80	38	37
Land Rent[8]	100	0.00	0	0
Subtotal Fixed Watermelon Crop Costs	147		38	37
Total Watermelon Crop Costs	**$1,218**		**$150**	**$120**

[1] The required production costs for watermelons were summarized from the Texas Crop Profile on Watermelons by the Texas Agricultural Extension Service. These commodity costs were based on an average of 1996 through 1998 data.

[2] OIG applied an application factor to the production costs summarized from the Texas Crop Profile on Watermelons to determine an average of the costs incurred by the custom farmers. We based the application factor on the understanding that the watermelon crop failed within 1 to 2 months after planting and therefore did not require the necessary variable costs of fertilizer, pesticide, irrigation, and labor. We also applied a factor to the total fixed machinery and equipment costs because a majority of the land usually sat idle during the fall and the custom farmers used the same equipment to plant their spring crops.

[3] These individual amounts were summarized from a custom farming expense list turned into the Hidalgo County Office by the producer.

[4] Since the seed was provided by the producer and the custom farmer did not incur this cost, we did not include this expense for comparison purposes.

[5] The crop failed within 1 to 2 months after planting and did not require fertilizer, pesticide, or other applications that would have been required if the watermelon crop reached full maturity.

[6] The adjustor's report stated that many fields were never irrigated due to excess rainfall at the time of planting. Many were irrigated once, and a very few were irrigated twice. We included an average of one irrigation for all the custom farmers.

[7] Flood irrigation was used instead of drip-tape irrigation. Also, plastic mulch was not used to plant the crop.

[8] Land rent was not included in the comparison because there was a separate agreement between the producer and the custom farmers for a reimbursement rate of $100 per acre.

EXHIBIT F – COMPARISON OF CROP EXPENSES INCURRED WITH OTHER WATERMELON PRODUCERS

Crop Cost Description	Required Cost Amount[1]	Average Crop Expense For Custom Farmers[2]	Producer With 2nd Largest Fall Claim	Producer With 3rd Largest Fall Claim
Variable Watermelon Crop Costs				
Seed[3]	60	0	0	0
Fertilizer[4]	32	16	6	15
Pesticide (herbicide, insecticides, fungicides)[4]	110	37	37	48
Irrigation 4 applications at $9 per app. [5]	36	9	135	103
Drip Tape[6]	225	0	0	0
Machinery Labor Cost	18	18	0	50
Other Labor Cost[4]	65	32	68	0
Harvest Expense[4]	350	0	0	0
Plastic Mulch[6]	175	0	0	0
Subtotal	1071	112	246	216
Less Irrigation Expense			126	94
Subtotal Variable Watermelon Crop Costs			120	122
Fixed Watermelon Crop Costs				
Machinery and Equipment[4]	47	38	30	0
Land Rent[8]	100	0	0	0
Subtotal Fixed Watermelon Crop Costs	147	38	30	0
Total Watermelon Crop Costs Per Acre	$1,218	$150	$150	$122

[1] The required production costs for watermelons were summarized from the Texas Crop Profile on Watermelons prepared by the Texas Agricultural Extension Service. These commodity costs were based on an average of 1996 through 1998 data.

[2] All of the custom farmers were asked to submit cancelled checks and invoices for crop expenses incurred for the watermelon crop. However, only seven custom farmers submitted some type of documentation. Irrigation records were submitted by five custom farmers, pesticide receipts were submitted by four custom farmers, and fertilizer receipts were submitted by one custom farmer.

[3] Since the seed was provided by the producer, we did not include it in the comparison with production costs for other producers.

[4] The crop failed within 1 to 2 months after planting and did not require necessary inputs of fertilizer, pesticide, or other costs that would have been required if the watermelon crop reached full maturity. (See exhibit E for computation of the average crop expense for custom farmers.)

[5] The adjuster's report stated that many fields were never irrigated due to excess rainfall at the time of planting. Many were irrigated once, and a very few were irrigated twice. (See exhibit E for computation of the average crop expense for custom farmers.)

[6] Flood irrigation was used instead of drip-tape irrigation. In addition, plastic mulch was not used.

[7] For comparison purposes, only $9 was included in the comparison for irrigation expense ($135 - $9 = $126, $103 - $9 = $94) because the crop insurance adjuster stated that most fields were never irrigated, while only a few were irrigated more than once.

[8] The land rent was not included in the comparison because there was a separate agreement between the producer and the custom farmers for a reimbursement rate of $100 per acre.

United States Department of Agriculture

Farm and Foreign Agricultural Services
Risk Management Agency

SEP 24 2002

TO: Richard D. Long
Assistant Inspector General for Audit
Office of Inspector General

FROM: Garland D. Westmoreland
Agency Audit Liaison Official

SUBJECT: OIG Draft Report Number 05601-9-Te – Review of Large Insurance Claim for Watermelons in South Texas

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

RECOMMENDATION NO. 1

Determine by seeking an OGC opinion, whether the producer misrepresented his share of the insured crop and, as a result, violated the common crop insurance policy.

RMA Response:

RMA concurs with the recommendation. A request for OGC opinion was made on September 16, 2002. (See attached)

RMA requests management decision for this recommendation based on the above actions.

RECOMMENDATION NO. 2

If OGC determines that the producer misrepresented his share of the crop, void the entire policy and pursue collection from the insurance provider the questioned indemnities paid out under the policy to the producer.

•1400 Independence Ave., SW• Stop 0801•Washington, DC 20250-0801

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

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RMA Response:

RMA conditionally concurs with the recommendation. The RMA, Southern Regional Compliance Office, (SRCO) has requested the policy documents from the reinsured company, and received the OIG audit work papers. Once the OGC opinion is received, the SRCO will review and validate the OIG findings and recommendation, and determine the appropriate action(s). We will notify your office of our determination(s).

RECOMMENDATION NO. 3

> Add to section 21 of the common crop insurance policy a paragraph that will require the insured to maintain complete records for any expenses associated with growing the crop and that will incorporate the same maintenance and penalty requirements already established for production records.

RMA Response:

RMA concurs with the recommendation. Section 21 of the Basic Provisions Policy Proposed Rule contains language requiring that for 3 years after the end of the crop year, the insured must retain, and provide upon request, complete records of the planting, replanting, inputs, production, harvesting, and disposition of the insured crop on each unit. The proposed rule also makes the penalty for failure to maintain records for expenses associated with the growing the crop the same as the penalty for failure to provide production records.

The proposed rule was published in the Federal Register on September 18, 2002, with comment period ending October 18, 2002. The final rule may be effective for either the spring 2003 crop year, or the 2004 crop year. We believe the language in section 21 of the Basic Provisions addresses recommendation No. 3 and request management decision for this recommendation.

RECOMMENDATION NO. 4

> Determine whether the interaction of the insurance agency, individuals A and B, and the producer for the 1999 fall watermelon crop insurance proceeds constituted a conflict of interest.

RMA Response:

RMA conditionally concurs with the recommendation. The RMA, SRCO has requested the policy documents from the reinsured company, and received the OIG audit work papers. The SRCO will review and validate the OIG findings and recommendation, and determine the appropriate action(s). We will notify your office of our determination(s).

RECOMMENDATION NO. 5

If an adverse determination is made for recommendation number 4, take appropriate action against the insurance agency, his son, and the producer for their participation in the conflict of interest situation, up to and including any legal sanction or debarment.

RMA Response:

RMA conditionally concurs with the recommendation. The RMA, SRCO has requested the policy documents from the reinsured company, and received the OIG audit work papers. The SRCO will review and validate the OIG findings and recommendation, and determine the appropriate action(s). We will notify your office of our determination(s).

RECOMMENDATION NO. 6

Issue a manager's bulletin to all insurance companies clarifying the business relationships and other potential conflicts of interest involving insurance agents, loss adjusters, and producers that must be disclosed or reported to the companies.

RMA Response:

RMA concurs with the recommendation. RMA will draft a Manager's Bulletin to require crop insurance agents to disclose any business relationship, outside of the crop insurance agent-insured relationship, with a person or entity that they insure. This would include the leasing of land and providing custom farming services. RMA believes this requirement is covered by current language in the Standard Reinsurance Agreement. RMA plans to complete this action by December 31, 2002, and requests management decision for this recommendation based on the above actions.

If there are any questions, please contact Alan Sneeringer on (202) 720-8813.

Attachment

USDA

United States Department of Agriculture

Farm and Foreign Agricultural Services
Risk Management Agency

SEP 16 2002

ACTION MEMORANDUM

TO: **KIMBERLEY E. ARRIGO**
SENIOR COUNSEL
COMMUNITY DEVELOPMENT DIVISION

FROM: **GARLAND WESTMORELAND**
DEPUTY ADMINISTRATOR, COMPLIANCE

SUBJECT: **OFFICE OF INSPECTOR GENERAL AUDIT RECOMMENDATIONS**
OIG AUDIT REPORT NUMBER 05601-9-TE
(RE: COMPLIANCE CASE NUMBER SRCO-3049)

The Office of Inspector General (OIG) has issued a recommendation (Recommendation No. 1, page 13) in the subject audit report that states the Risk Management Agency (RMA) is to determine, by seeking an Office of the General Counsel (OGC) opinion, whether the producer misrepresented his share of the insured fall watermelon crop, and as a result, violated the common crop insurance policy. The OIG audit also recommended (Recommendation No. 2, page 13) that if OGC determines that the producer misrepresented his share of the fall crop, RMA should void the entire policy and collect from the insurance provider $6,998,779 ($5,519,728 for the fall 1999 claim and $1,479,051 for the spring 1999 claim) in total indemnities paid out under the policy to the producer. The OIG did not question the legitimacy of the spring crop payment.

We request that you provide an opinion if the producer cited in the report misrepresented his share of the insured crop in violation of the common crop insurance policy while participating in both the fall and spring 1999 pilot watermelon crop insurance program. Also, if you determine that the producer did misrepresent his share of the insured crop, we will have the Southern Regional Compliance Office initiate action to recover the funds and, if appropriate, initiate civil action.

Enclosed is a copy of the discussion draft OIG Audit Report Number 05601-9-TE for your review. Also enclosed are actuarial documents; policy provisions; Manager's Bulletin 99-025,

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1999 Crop Year Watermelon Pilot Crop Insurance Program Issues; and loss adjustment standards for the watermelon pilot program. SRCO has requested the OIG workpapers for the audit and will provide those to you if needed. If you have any questions or need additional information, please contact SRCO Compliance Investigator, Sandra Warstler at (214) 767-772 or Loren Clark at 720-4583.

Enclosures

cc: ORC/Chron
SRCO
Alan Snerringer