
BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Examination Of The Federal Crop Insurance Corporation's Financial Statements For The Year Ended September 30, 1984

GAO examined the financial statements of the Federal Crop Insurance Corporation (FCIC) for the year ended September 30, 1984. The examination was made in accordance with generally accepted government auditing standards.

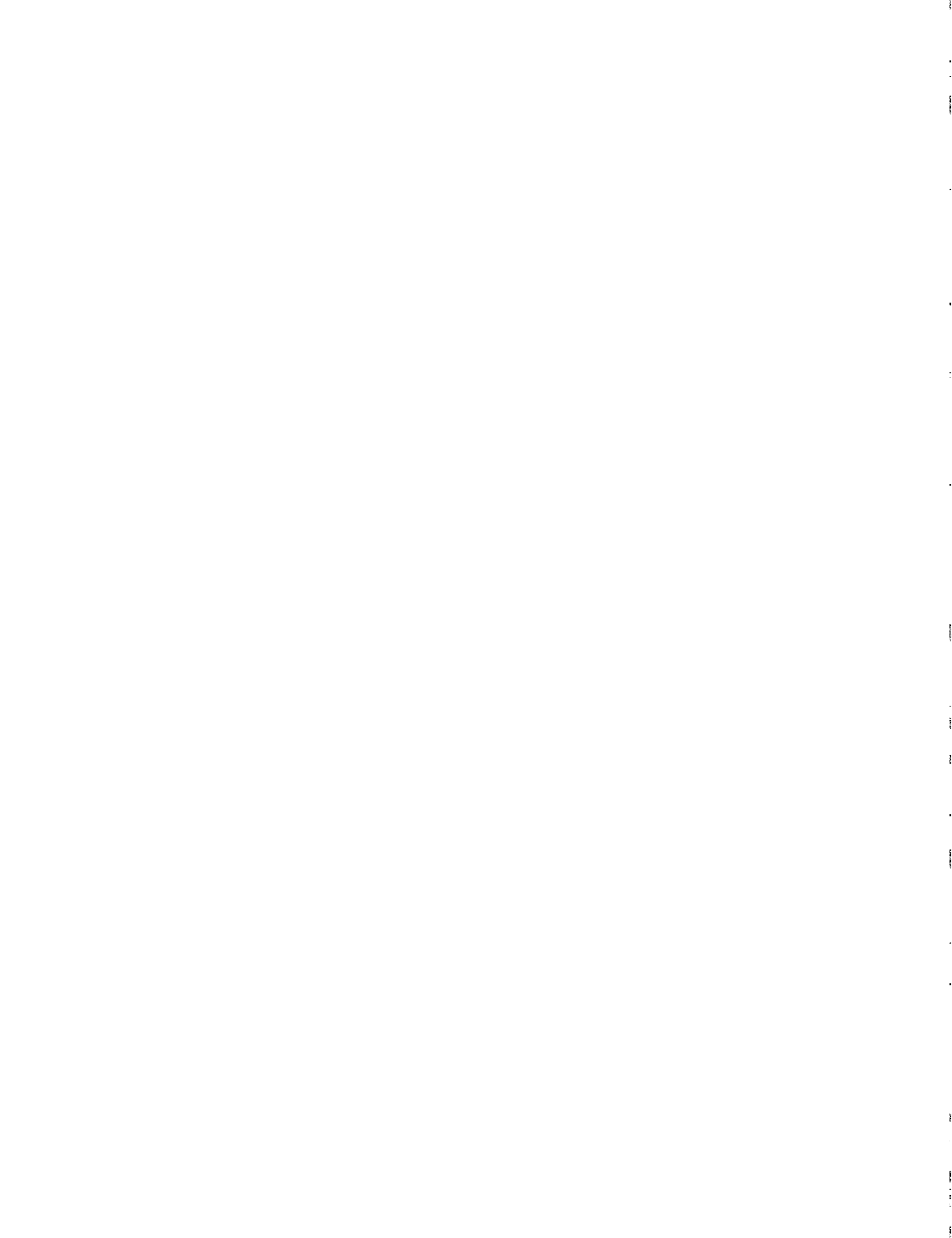
In fiscal year 1984, the FCIC incurred a current year loss of \$211 million from insuring agricultural crops against all unavoidable risks, and it could sustain future losses in subsequent periods. FCIC has not established premium rates that adequately cover losses on insured crops and, thereby, enable FCIC to build a reasonable reserve against unforeseen losses, as authorized by the Federal Crop Insurance Act. FCIC's losses from operations since fiscal year 1981 have resulted in a negative capital position as of September 30, 1984, of \$11 million. FCIC contends that adverse weather conditions caused the fiscal year 1984 losses. FCIC has made the Congress aware of its financial difficulties and has requested additional funding authority to pay producers' claims.

In GAO's opinion, the financial statements present fairly the deficit financial position of FCIC as of September 30, 1984, and the losses as a result of its 1984 operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles consistently applied, except for a change in the method of matching costs and revenues with which GAO concurs. The change resulted in an additional loss of \$191 million.



GAO/AFMD-85-54
SEPTEMBER 30, 1985

032654





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-114834

To the President of the Senate and the
Speaker of the House of Representatives

This report transmits our opinion on the financial statements of the Federal Crop Insurance Corporation for the year ended September 30, 1984. Our opinion emphasizes our concern about the inadequate premium rates and the Corporation's negative capital position. Appendix I is our report on the Corporation's system of internal accounting controls, and appendix II is our report on the Corporation's compliance with laws and regulations. The Comptroller General is required to audit the financial transactions of the Federal Crop Insurance Corporation under 31 U.S.C. 9105, and we conducted our examinations in accordance with generally accepted government auditing standards.

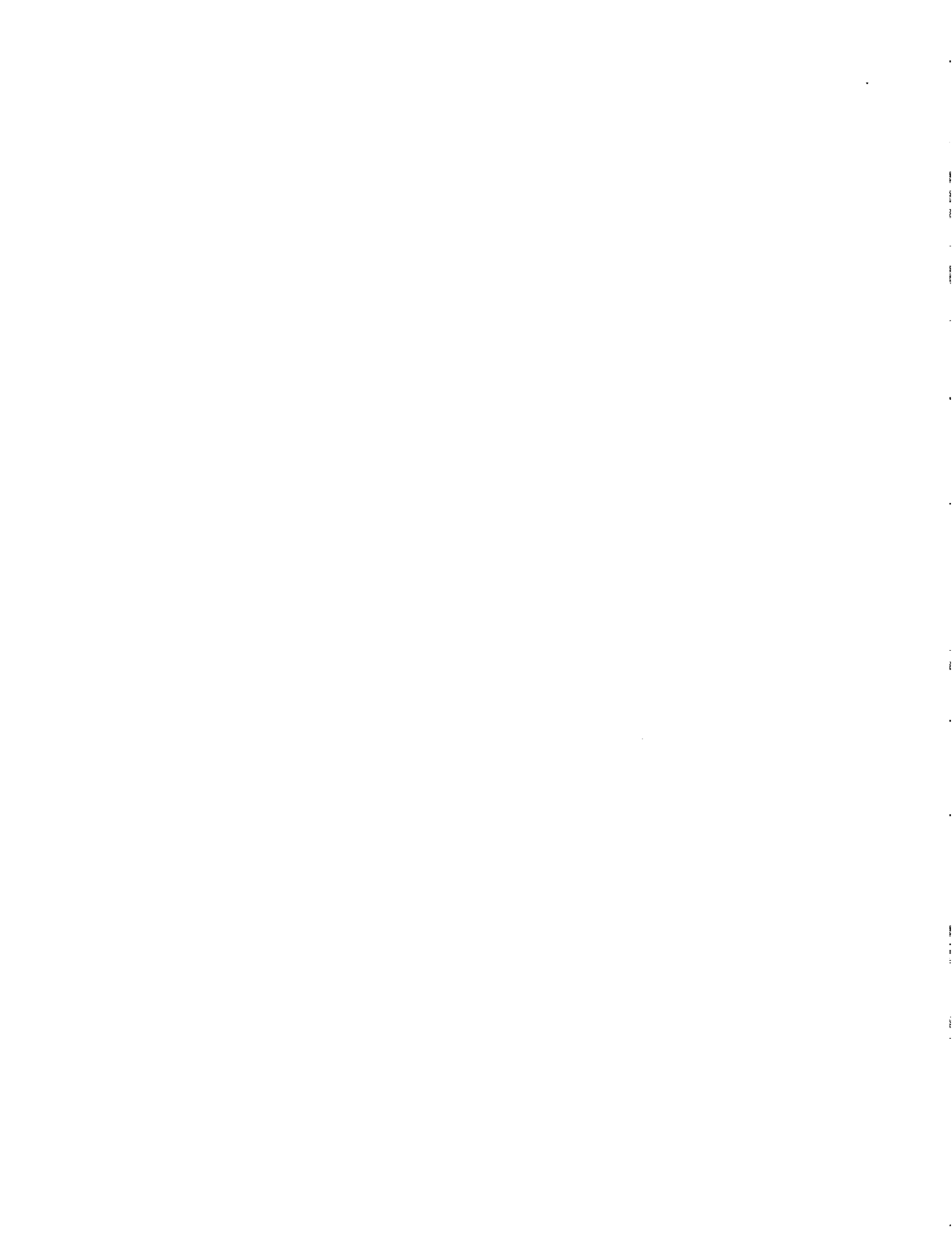
The Federal Crop Insurance Corporation is a wholly owned government corporation which was created in 1938 to provide farm producers with crop insurance as protection against losses resulting from unavoidable causes, such as weather, insects, and disease.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of Agriculture, the Federal Crop Insurance Corporation's Board of Directors, and the Manager of the Corporation.

Sincerely yours,

A handwritten signature in black ink that reads "Charles A. Bowsher".

Comptroller General
of the United States





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-114834

To the Board of Directors
Federal Crop Insurance Corporation

We have examined the statement of financial condition of the Federal Crop Insurance Corporation (FCIC) as of September 30, 1984, and the related statements of loss and changes in accumulated deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In 1984, the FCIC incurred a loss of \$211 million from insuring agricultural crops against all unavoidable risks, and it could sustain future losses in subsequent periods. FCIC has not established premium rates that adequately cover losses on insured crops and, thereby, enable FCIC to build a reasonable reserve against unforeseen losses, as authorized by the Federal Crop Insurance Act. FCIC's losses from operations since fiscal year 1981 have resulted in a negative capital position as of September 30, 1984, of \$11 million. FCIC contends that adverse weather conditions caused the fiscal year 1984 losses. FCIC has made the Congress aware of its financial difficulties and has requested additional funding authority to pay producers' claims. FCIC is in the process of examining the potential for premium rate increases, adjusting the level and extent of coverage on the basis of individual policyholders' histories, and spreading potential risk through reinsurance contracts.

In our opinion, the financial statements referred to above present fairly the deficit financial position of the Federal Crop Insurance Corporation as of September 30, 1984, and the losses as a result of its 1984 operations, and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles which, except for the change, with which we concur, in the method of matching costs and revenues, as described in note 2(B) to the financial statements, have been applied on a basis consistent with that of the preceding year.

March 15, 1985

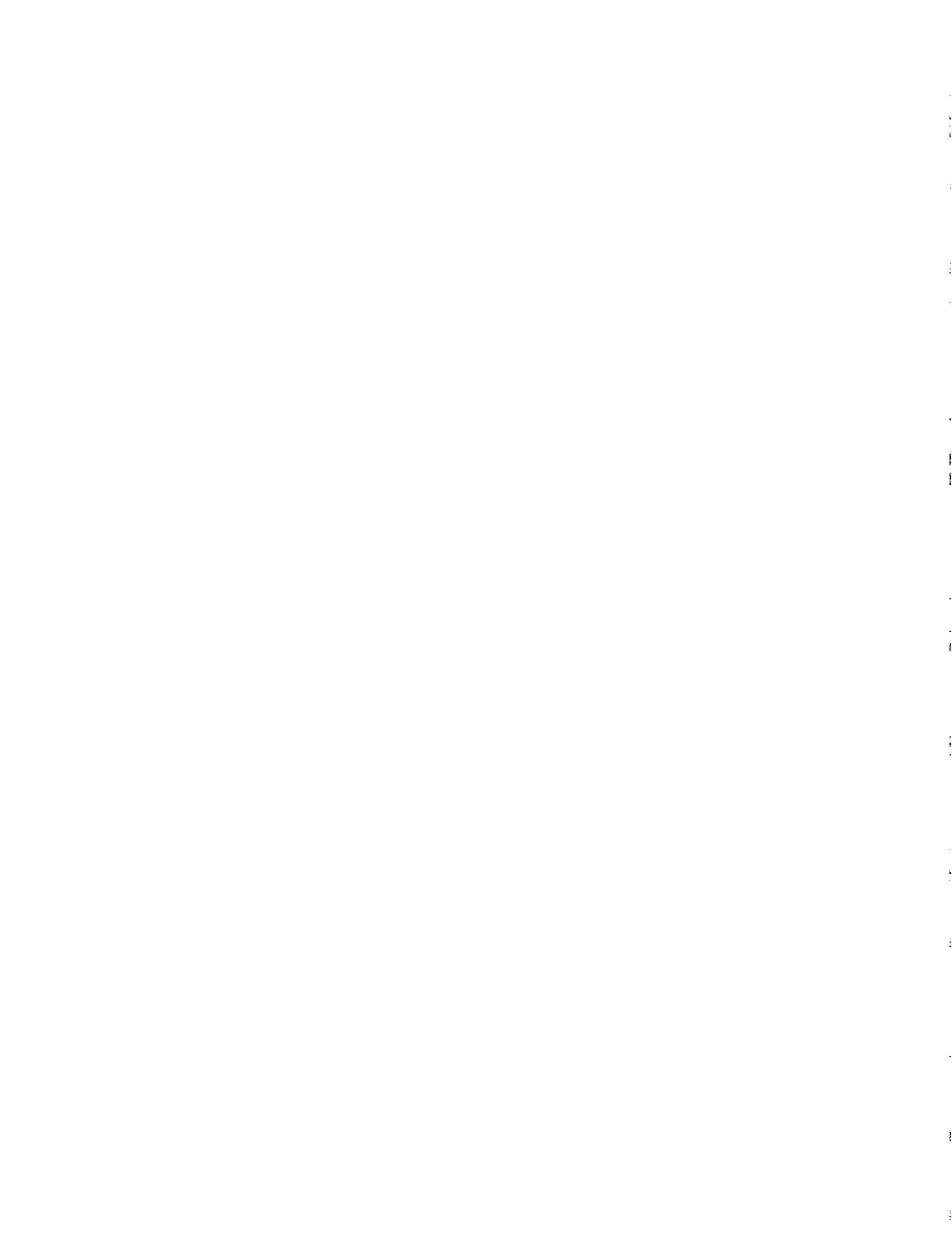
A handwritten signature in cursive script, reading "Charles A. Bowsher".

Comptroller General
of the United States



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REPORT ON INTERNAL ACCOUNTING CONTROLS

We have examined the financial statements of the Federal Crop Insurance Corporation (FCIC) for the year ended September 30, 1984, and have issued our report thereon. As part of our examination, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. For the purpose of this report, we have classified the significant internal accounting controls in the following categories:

- billing,
- claims,
- disbursements,
- receipts,
- reinsurance,
- reporting, and
- sales.

Our study included all of the control categories listed above except that we did not evaluate the accounting controls over all functions within any of the categories because it was more efficient to evaluate certain key internal controls and to expand substantive audit tests. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on FCIC's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole or on any of the categories identified above.

The management of FCIC is responsible for establishing and maintaining a system of internal accounting controls. In fulfilling this responsibility, management is required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that (1) assets are safeguarded against loss from unauthorized use or disposition and (2) transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

Our study and evaluation was made for the limited purpose described in the first paragraph and would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting controls of FCIC taken as a whole or on any of the categories of controls identified in the first paragraph. However, our study and evaluation disclosed no condition that we believed to be a material weakness.

Certain matters which were not material to the financial statements were noted during our audit and have been communicated to FCIC officials by separate management letters.

REPORT ON COMPLIANCE WITH LAWS
AND REGULATIONS

We have examined the financial statements of the Federal Crop Insurance Corporation (FCIC) for the year ended September 30, 1984, and have issued our opinion thereon. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances.

In our opinion, FCIC complied with the terms and provisions of laws and regulations for the transactions tested that could have materially affected its financial statements.

Nothing came to our attention in connection with our examination that caused us to believe that FCIC was not in compliance with the terms and provisions of laws and regulations for those transactions not tested. However, FCIC has not established premium rates that adequately cover losses on insured crops, which would allow FCIC to build a reasonable reserve against unforeseen losses, as authorized by the Federal Crop Insurance Act. FCIC contends that adverse weather conditions caused the fiscal year 1984 losses.

Certain compliance matters which were not material to the financial statements were noted during our audit and have been communicated to FCIC officials by separate management letters.

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF FINANCIAL CONDITION
AS OF SEPTEMBER 30, 1984
(in thousands of dollars)

ASSETS

Cash in U.S. Treasury:		
Administrative funds	\$ 95,121	
Insurance program funds	<u>62,501</u>	\$157,622
Accounts receivable:		
Producers	131,506	
Administrative funds	42,120	
Other	176	
Less: Allowance for doubtful accounts	<u>(6,069)</u>	167,733
Furniture and equipment (note 2J)	2,655	
Less: Accumulated depreciation	<u>(541)</u>	<u>2,114</u>
Total assets		<u>\$327,469</u>

LIABILITIES AND CAPITALLiabilities:

Accounts payable:		
Estimated losses	\$146,714	
Agents' commissions	18,035	
Loss adjustment	768	
Reinsured companies	122,187	
Other	<u>10,829</u>	\$298,533
Unearned premiums		38,296
Accrued annual leave		<u>1,805</u>
Total liabilities		<u>338,634</u>

Commitments and contingencies (note 3)

Capital (note 2F):

Capital stock (\$500,000 authorized)		
issued and outstanding (note 2E)	450,000	
Paid in capital	37,978	
Accumulated deficit	(505,956)	
Unexpended appropriations (note 2G)	<u>6,813</u>	<u>(11,165)</u>
Total liabilities and capital		<u>\$327,469</u>

The accompanying notes are an integral part of these financial statements.

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF LOSS AND CHANGES IN
ACCUMULATED DEFICIT
FOR THE YEAR ENDED SEPTEMBER 30, 1984
(in thousands of dollars)

REVENUES

Premiums earned:		
Direct sales (notes 2B and 2H)	\$180,068	
Reinsurance premium less company share of gain of \$2,348 (notes 2D and 2H)	218,571	
Puerto Rico reinsurance premium less company share of gain of \$297 (notes 2D and 2H)	<u>1,855</u>	\$400,494
Interest earned		3,599
Other		<u>34</u>
Total revenues		<u>404,127</u>

EXPENSES

Insurance losses:		
Direct claims (notes 2B and 2C)	271,912	
Reinsurance less company share of \$6,147 (note 2D)	337,209	
Puerto Rico reinsurance (note 2D)	<u>821</u>	609,942
Insurance servicing costs:		
Sales agents' commissions (note 2B)	25,535	
Loss adjustment (note 2B)	12,908	
Reinsurance administrative (note 2D)	53,328	
Reinsurance loss adjustment (note 2D)	19,039	
Losses and other costs for prior years (note 2C)	3,342	
Bad debts	<u>2,264</u>	116,416
Administrative:		
Personnel compensation and benefits (note 2I)	33,659	
Contractual services	9,582	
Travel and transportation	6,212	
Depreciation	207	
Other	<u>11,538</u>	61,198
Total expenses		<u>787,556</u>
(LOSS) FROM OPERATIONS (note 2C)		(383,429)

OTHER FINANCING SOURCES

Expended operating appropriations	<u>172,008</u>
(LOSS) FOR CURRENT YEAR (note 2C)	(211,421)
Cumulative effect of change in accounting principle (note 2B)	<u>(191,346)</u>
NET (LOSS) (note 2C)	<u>(402,767)</u>
Accumulated deficit, beginning of fiscal year	(128,072)
Reimbursement for FY 1982 expenses	<u>24,883</u>
Accumulated deficit, end of fiscal year	<u>(\$505,956)</u>

The accompanying notes are an integral part of these financial statements.

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR THE YEAR ENDED SEPTEMBER 30, 1984
(in thousands of dollars)

FUNDS PROVIDED

Funds provided from operations:	
Net (loss)	\$(402,767)
Depreciation	207
Sale of stock (note 2E)	50,000
Reimbursement for FY 1982 expenses	24,883
Decrease in accounts receivable (net)	6,308
Decrease in deferred charges (note 2B)	549,375
Increase in unexpended appropriations	<u>5,949</u>
Total funds provided	<u>233,955</u>

FUNDS APPLIED

Purchase of equipment	351
Decrease in accounts payable	226,744
Decrease in unearned premium (note 2B)	<u>249,713</u>
Total funds applied	<u>476,808</u>

DECREASE IN CASH	<u><u>\$242,853</u></u>
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CHANGE IN CASH BALANCE:

Cash, September 30, 1983	\$400,475
Cash, September 30, 1984	<u>157,622</u>
DECREASE IN CASH	<u><u>\$242,853</u></u>

The accompanying notes are an integral part of these financial statements.

FEDERAL CROP INSURANCE CORPORATION
NOTES TO FINANCIAL STATEMENTS

Note 1. STATEMENT OF CORPORATE PURPOSE

The Federal Crop Insurance Corporation (FCIC) was created on February 16, 1938, and is a wholly owned government corporation under 31 U.S.C. 9101(3)(C). FCIC manages several programs to stabilize and protect the farm sector of the nation's economy. It was restricted in both geographic area and crops covered until 1980, when major amendments created what is virtually a new organization. However, FCIC's purpose remained the same.

Essentially, the Federal Crop Insurance Act of 1980, Public Law No. 96-365, 94 Stat. 1312 (September 26, 1980), called for improving the insurance program and expanding it nationwide in order to eventually phase out the disaster-payment program. The act called for an actuarially sound nationwide cost-sharing insurance program for agricultural producers to protect their production investment against essentially all unavoidable risks. The new legislation provided that FCIC shall, among other things:

- use the private sector, to the maximum extent possible, to sell and service crop insurance;
- provide higher coverage levels;
- encourage the broadest possible participation in the program by having FCIC subsidize a portion (not to exceed 30%) of the producers' premium;
- provide a test program of reinsurance consistent with sound reinsurance principles (whereby part or all of the risk is transferred from the original party to another party), to the maximum extent possible, to begin not later than with the 1982 crops; and
- conduct, beginning in the 1981 crop year and ending after the 1985 crop year, a pilot program which tailors crop insurance to the individual producer's risk in no fewer than 25 counties. This program allows producers to obtain an increase in the coverage offered based on actual-yield history.

For the 1984 crop year, crop insurance expanded coverage in 924 counties with new crop policies on 23 commodities. Coverage was further extended to 999 counties on an additional 17 crops for the 1985 crop year.

A new Actual Production History program was developed for the 1985 crop year for corn, grain sorghum, peanuts, and tobacco. This program builds on the model developed in 1984 for cotton and rice. FCIC plans to convert all crop insurance programs to a proven production basis for yield guarantee by 1987.

Note 2. SIGNIFICANT ACCOUNTING POLICIES

- (A) Accounting basis - The Federal Crop Insurance Corporation maintains separate funds for the insurance program and administrative support. However, for financial statement presentation purposes, the two funds are combined. Furthermore, amounts presented in the financial statements are condensed to the extent possible. Supporting information for the condensed amounts is provided in the accompanying notes.

Estimated losses are based on incidents which have occurred and which will ultimately result in FCIC making payments. The estimate includes amounts for which claims had been submitted, but not settled as of the fiscal year-end, and amounts for claims which had not been submitted.

Premium revenue is based on a number of factors including the type of crop, number of acres planted, location, price selected by the insured to be used in the event of a covered loss, and the insured's previous loss experience. FCIC's risk of loss generally commences when the crop is planted and continues until the crop is harvested, destroyed, or removed from the field, subject to a termination date which follows the usual harvest period.

The insured must file an acreage report with FCIC promptly after planting to ensure that the crop is covered. Insurance coverage may be denied if reports are not submitted promptly, if crops are planted late, and for other reasons. FCIC recognizes premium income over the period of risk.

- (B) Change in accounting principle - The method of matching cost and revenues in the financial statements changed in fiscal year 1984 from prior years to bring the statements into conformance with generally accepted accounting principles, including Financial Accounting Standards Board Statement Number 60 "Accounting and Reporting by Insurance Enterprises." FCIC historically deferred all revenues and claims of the current crop year for inclusion in the following fiscal year. Other expenses were recognized in the fiscal year they were paid.

In fiscal year 1984, FCIC spread premium revenue over the period of risk using historical information on when crop losses occurred, and recognized only the income and the acquisition costs that related to fiscal year 1984 operations.

FCIC also recognized estimated losses and the related loss-adjustment expenses on the same basis as it recognized premium revenue. These loss-adjustment expenses are included in the 1984 statements on a percentage basis using the average cost to settle a claim. The cumulative effect of this change in accounting principle is to increase the loss for fiscal year 1984 by \$191,345,846.

FCIC reports only agents' commissions and reinsurance administrative expenses as acquisition costs since they are the only expenses that vary with and are directly related to acquiring new and renewal business. Financial Accounting Standards Board Statement Number 60 requires insurance companies to capitalize and amortize acquisition costs in proportion to premium revenue recognized. As of September 30, 1984, FCIC did not have any prepaid acquisition costs because it does not pay most acquisition costs until the premium is collected. Most of the premium earned at September 30, 1984, has not been collected.

- (C) Change in accounting estimate - In fiscal year 1984, FCIC reduced its estimate of losses by \$29,913,861. This reduction relates to crop-year-1981 claims for sugar-beet losses in North Dakota and Minnesota, which FCIC is currently disputing in court. FCIC recognized these losses in fiscal year 1982 but reversed them in fiscal year 1984 because of a remote likelihood of payment. The effect of this change in estimate was to decrease FCIC's fiscal year 1984 loss from operations, loss for current year, and net loss by \$29,913,861.

FCIC also has losses and other costs related to prior years of \$3,342,116. This amount represents (1) adjustments to crop years 1948 to 1981 premiums and losses, (2) adjustments to crop-year-1982 agents' commissions expenses, and (3) adjustments to crop-year-1982 reinsurance administrative expenses.

- (D) Reinsurance - Section 106(4) of the Federal Crop Insurance Act of 1980 authorized FCIC to enter into reinsurance agreements with private insurance companies under which FCIC assumes most of the risk of loss to a specified limit on crop-insurance policies written by these companies. In fiscal year 1984, FCIC had two reinsurance agreements--its standard agreement with 43 companies to sell multiperil crop insurance, and an

agreement with one company to sell crop insurance in Puerto Rico, which primarily protects against hurricane damage. FCIC and the reinsured companies share the reinsurance income and losses based on the ratio of losses to premiums. FCIC also reimburses the companies for administrative and loss-adjustment expenses on a percentage of premiums and/or loss basis. Furthermore, FCIC's contracts with the reinsured companies provide that the lesser of (1) 5 percent of gross premiums or (2) 20 percent of FCIC's share of reinsurance income and loss will be accumulated for a 5-year period beginning in 1981. After 5 years, the FCIC and reinsured company shares of reinsurance income or loss will be recalculated and the amounts due to the company will be adjusted accordingly. As of September 30, 1984, FCIC had accumulated \$840,027 for subsequent payment to the reinsured companies.

In fiscal year 1984, FCIC's share of reinsurance premiums was \$220,425,873, while its share of losses was \$338,030,881, including crop-year-1983 Puerto Rico reinsurance premiums of \$1,854,575 and losses of \$821,344. The companies' share of premiums was \$2,885,484 and their share of losses was \$6,146,746. FCIC's reinsurance premiums, losses, administrative expenses, and loss-adjustment expenses are accounted for using the same method as FCIC uses for its direct business.

- (E) Capital - Section 101 of the Federal Crop Insurance Act of 1980 directed the cancellation of outstanding capital stock within 30 days after September 26, 1980, and increased the authorized amount of capital stock subscription from \$200 to \$500 million. In accordance with the mandate of the act, capital stock of \$200 million was canceled. Cumulative expenses and the direct cost of loss adjustment paid from the fund were written off and a balance of \$38 million from the \$200 million was regarded as paid-in-capital. Borrowing authority from the Department of the Treasury was contained in the 1980 legislation, but FCIC had not used it as of September 30, 1984.

Section 110 of the Federal Crop Insurance Act of 1980 authorized the Secretary of Agriculture to use the funds of the Commodity Credit Corporation (CCC) to pay FCIC losses if funds available to FCIC were insufficient for that purpose. During the 1981 fiscal year, \$250 million of CCC funds were used to pay losses. Under terms of the act, the authority to use CCC funds expired October 26, 1981, one year from the date it was first used.

Issuance of capital stock was as follows:

	<u>(millions)</u>
P.L. 97-103, approved December 23, 1981	\$250
P.L. 97-370, approved December 18, 1982	150
P.L. 98-396, approved August 22, 1984	<u>50</u>
Total stock issued	<u>\$450</u>

- (F) Negative capital position - FCIC's operations since fiscal year 1981 have resulted in an accumulated deficit to the point that FCIC now is in a negative capital position. FCIC attributes this negative position primarily to adverse weather conditions. The Corporation has made the Congress aware of its financial position and has requested additional funding authority.
- (G) Unexpended appropriations - FCIC receives annual appropriations for administrative and operating expenses. Depending on whether the funds have been obligated and the service or product constructively delivered, the appropriations are presented on either the Statement of Financial Condition or the Statement of Loss and Accumulated Deficit. The Statement of Loss includes all funds that have been obligated and the related service or product constructively delivered, while the Statement of Financial Condition includes obligated funds for undelivered orders--unexpended appropriations.

The following schedule summarizes the status of appropriated funds for fiscal year 1984.

Unexpended appropriations at September 30, 1984	\$1,141,050
Plus: Adjustment for unexpended appropriations to comply with generally accepted accounting principles	5,597,065
Restriction for small-claims contingencies	<u>75,000</u>
Total obligated and unexpended appropriations	<u>\$6,813,115</u>

(H) Premium subsidy - Section 106(1) of the Federal Crop Insurance Act of 1980 directed that FCIC pay a portion of producers' insurance premiums and provided appropriations for that purpose. FCIC includes the subsidy received from appropriations as income in the year earned. Since 1981, FCIC has been paying 30 percent of each producer's premium on any coverage up to a maximum of 65 percent of recorded or appraised average yield. FCIC's share of premiums during fiscal year 1984 was as follows.

Share of direct sales	\$29,484,041
Share of reinsurance sales	51,906,875
Share of Puerto Rico reinsurance sales	<u>370,388</u>
Total premium subsidy	<u><u>\$81,761,304</u></u>

(I) Pensions - Most permanent employees of FCIC hired prior to January 1, 1984, are covered by the Civil Service Retirement System. However, permanent employees in the Senior Executive Service have the option of being covered by the Social Security Retirement and Disability Insurance System. All temporary employees of FCIC, as well as permanent employees hired on or after January 1, 1984, are also covered by the Social Security Retirement and Disability Insurance System. During fiscal year 1984, FCIC contributed \$1,409,125 to the Civil Service Retirement System and \$591,757 to the Social Security Retirement System.

(J) Furniture and equipment - Furniture and equipment are recorded at cost or transferred value and are depreciated on a straight-line basis over an estimated useful service life. Repairs and maintenance are expensed as incurred. However, improvements which extend the useful life of an item or increase its productive capacity are capitalized at cost.

Note 3. COMMITMENTS AND CONTINGENCIES

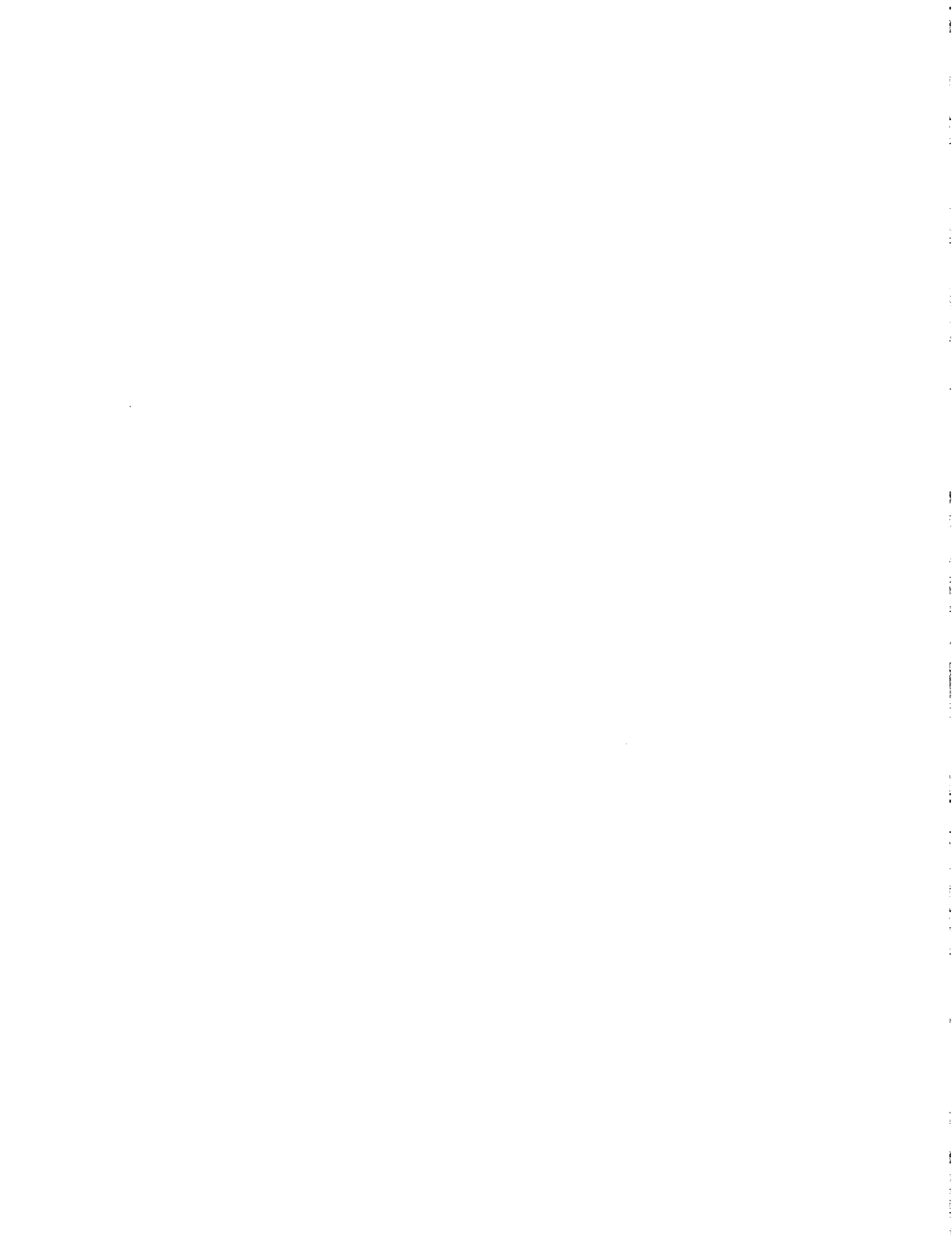
(A) Lease commitments - FCIC leases data processing equipment directly from private contractors and through the General Services Administration. For the most part, these operating leases are renewable at FCIC's option. Lease expense for fiscal year 1984 was \$117,278.

(B) Contingent liabilities - Currently, there are a number of lawsuits filed against FCIC concerning disputes on claims. FCIC's legal representatives consider it highly unlikely that FCIC will receive material adverse

judgments on any of these cases and could not reasonably estimate the amount of loss. However, on March 22, 1985, the United States Court of Appeals for the Eighth Circuit reversed a summary judgment by a District Court in favor of FCIC and remanded the case for future proceedings. This case involves crop year 1981 claims for sugar-beet losses in North Dakota and Minnesota. At this time, the amount of any loss cannot be reasonably estimated and FCIC believes that an unfavorable outcome is remote.

Note 4. SERVICES AND BENEFITS FURNISHED FCIC

Services and benefits, the cost of which are for the most part not readily determinable, have been furnished without charge to FCIC by other government agencies. Among these are audit and investigative services provided by the Offices of Audit and Investigation of the Department of Agriculture, legal services rendered by the Departments of Agriculture and Justice, and disbursing services furnished by the Department of the Treasury.



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