United States General Accounting Office 133193

GAO

Report to the Congress

June 1987

FINANCIAL AUDIT

Federal Crop Insurance Corporation's Financial Statements for 1986 and 1985

133193

039164

GAO/AFMD-87-36

GAO

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

Comptroller General
of the United States

B-114834

June 12, 1987

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

This report presents our opinion on the financial statements of the Federal Crop Insurance Corporation for the years ended September 30, 1986 and 1985, and our reports on the Corporation's system of internal accounting controls and on its compliance with laws and regulations. We conducted our examination under the provisions of 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

Our opinion on the financial statements is qualified subject to the effect of potential reinsurance claim overpayments. We also emphasize our concerns about the Corporation's continued losses, negative capital position, and the need for the Corporation to continue borrowing in order to sustain operations. These factors indicate that the Corporation may be unable to continue in existence without either financial assistance from the Congress or program changes to improve the Corporation's financial position.

Our report on the Corporation's internal accounting controls continues to disclose that it has a material weakness in internal controls over reinsured companies that sell and service crop insurance. GAO, the U.S. Department of Agriculture Office of Inspector General, and the Corporation are currently reviewing this problem in depth. We are also reporting a material weakness in the accounting system, which does not include complete information on insurance losses and premiums which is required for fair financial reporting by fiscal year.

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

for Charles A. Bowsher
Comptroller General
of the United States

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The Board of Directors
Federal Crop Insurance Corporation

We have examined the statements of financial condition of the Federal Crop Insurance Corporation as of September 30, 1986 and 1985, and the related statements of loss and changes in accumulated deficit and changes in financial position for the years then ended. Our examinations were 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.

At the conclusion of our fiscal year 1985 audit, we reported our concern to the Corporation and to the Congress that the Corporation had no assurance that financial information reported to it by reinsured companies was accurate (GAO/AFMD-86-58). During 1986, we conducted an examination of crop year 1985 and 1984 claims paid by reinsured companies in fiscal years 1986 and 1985, respectively, as did the U.S. Department of Agriculture inspector general. Total reinsurance claims were $436 million in 1986 and $474 million in 1985. Our tests of $14.1 million of 1986 reinsurance claims disclosed potential overpayments of $8.1 million. Inspector general auditors tested another $9.2 million of 1986 reinsurance claims and found potential overpayments of $4.8 million. Our review of $6.6 million of 1985 reinsurance claims disclosed potential overpayments of $6.2 million. Inspector general auditors tested another $0.7 million of 1985 reinsurance claims and found potential overpayments of $0.5 million. The potential overpayments were due primarily to a lack of thorough review and verification of claims submitted by producers to reinsured companies. Due to sampling plan limitations, the test results cannot be projected to the total of insurance claims paid in those years. As disclosed in note 8, the Corporation is reviewing these claims and assessing their collectibility. The Corporation is also performing reviews of other reinsurance claims to identify further potential overpayments. As a result, we are unable at this time to determine the ultimate effect of these potential overpayments on the Corporation's 1986 and 1985 financial statements or what portion, if any, can be recovered by the Corporation. The financial statements do not reflect any amounts due for such overpayments.

For the years ended September 30, 1986 and 1985, the Corporation incurred losses of $221 million and $222 million, respectively, from insuring agricultural crops, and it is likely that it will sustain further losses in subsequent periods. The Corporation has not established premium rates that adequately cover losses on insured crops and that would enable it to build a reasonable reserve against unforeseen losses, as authorized by the Federal Crop Insurance Act. The Corporation's position is that higher premium rates could adversely affect producer participation in the crop insurance program. The Corporation's losses from operations have resulted in an accumulated deficit of $959 million and a negative capital position of $420 million as of September 30, 1986. The Corporation has made the Congress aware of its financial difficulties and has received additional funding authority to pay producers' claims. As described in note 5, the Corporation, under the Food Security Act of 1985, has received $450 million of loans from the Commodity Credit Corporation in fiscal year 1986 and has borrowed $113 million from the U.S. Treasury to pay producers' losses. The Corporation has not made any repayments on these loans. As also described in note 5, the Corporation has available an additional $375 million from the Commodity Credit Corporation for future use. Even with these additional funds, the Corporation's financial position has not improved. As described in notes 5 and 7, the Corporation still faces financial difficulties in the future unless long-term solutions to its equity problem are instituted. Accordingly, the Corporation may be unable to continue in existence without either additional financial assistance from the Congress or program changes to improve the Corporation's financial position. The financial statements presented herein do not reflect adjustments which might be necessary should the Corporation be unable to continue in existence.

In our opinion, subject to the effect on the financial statements of the extent of potential reinsurance claim overpayments and their collectibility, as discussed in the second paragraph, the financial statements referred to above present fairly the financial position of the Federal Crop Insurance Corporation as of September 30, 1986 and 1985, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

for Frederick D. Wolf

Charles A. Bowsher
Comptroller General
of the United States

April 15, 1987

Report on Internal Accounting Controls

We have examined the financial statements of the Federal Crop Insurance Corporation for the years ended September 30, 1986 and 1985, and have issued our report thereon dated April 15, 1987. This report pertains only to our study and evaluation of the system of internal accounting controls for the year ended September 30, 1986. (Our report on the study and evaluation of the system of internal accounting controls for the year ended September 30, 1985, is presented in GAO/AFMD-86-58, dated September 19, 1986.)

As part of our examination, we made a study and evaluation of the Corporation's system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. 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 the Corporation's financial statements. For the purpose of this report, we have classified the significant internal accounting controls in the following cycles:

- cash,
- direct insurance losses,
- direct insurance sales,
- financial reporting, and
- reinsurance.

Our study and evaluation included all of the control cycles listed above. For each cycle, we obtained a knowledge and understanding of the control procedures, assessed the type and magnitude of errors and irregularities that could occur, and identified and evaluated the adequacy of significant internal accounting controls.

The management of the Corporation is responsible for establishing and maintaining a system of internal accounting controls. In fulfilling this responsibility, estimates and judgments by management are 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 made for the limited purpose described in the second paragraph would not necessarily disclose all material weaknesses in the system of internal accounting controls. Accordingly, we do not express an opinion on the system of internal accounting controls of the Corporation taken as a whole or on any of the control cycles identified in the second paragraph. However, our study and evaluation disclosed two conditions which we believe resulted in, or could result in, errors or irregularities in amounts material to the Corporation's financial statements, which may not be promptly detected. The two conditions, which are discussed below, relate to the Corporation's failure to (1) verify premium and loss information submitted by reinsured companies, which could lead to erroneous payments, and (2) collect data from reinsured companies needed to ensure that financial information is reported in accordance with generally accepted accounting principles. We considered these conditions in determining the nature, timing, and extent of the audit tests to be applied in our examination. We concluded that the weak internal controls over payments to reinsured companies would require a qualification of our opinion on the Corporation's financial statements for the years ended September 30, 1986 and 1985.

During the course of our examination, we did identify a number of other weaknesses in internal accounting controls and procedures which will be reported separately to the Corporation. Although we did not consider the other weaknesses to be material to the Corporation's financial statements, they nevertheless merit corrective action.

Failure to Verify Documentation for Crop Insurance Claims Causes Potential Overpayments

The Corporation, under agreements with reinsured companies which sell and service crop insurance policies, relied on the reinsured companies to verify claims information. In addition, the Corporation had no procedures to ensure that information reported by the reinsured companies was complete and accurate. Selective testing by us and the Department of Agriculture inspector general disclosed significant amounts of potential overpayments for claims paid in 1986 and 1985. Further, we identified a number of claims for losses from drought on irrigated land, which generally are payable only if there is a failure of the water supply from an unavoidable cause. These tests indicated that claims documentation was not being thoroughly reviewed and verified by the reinsured companies and the Corporation.

The Federal Crop Insurance Act of 1980 authorized the Corporation to enter into reinsurance agreements with private insurance companies under which the Corporation assumes most of the risk of loss on crop insurance written by the companies. Producers must meet certain tests of eligibility, timing of coverage, crop yield, acreage, and insurable interest, which determine the parameters on any loss that may occur. Producers submit loss claims to the reinsured companies who, in turn, settle the claims and submit claim summaries to the Corporation for payment.

In 1986, we conducted examinations of crop year 1984 and 1985 claims paid by reinsured companies in 1985 and 1986, respectively. We selected, on a judgmental basis, samples of claims paid over $20,000 and tested them for attributes of eligibility and other requirements. This testing included examination of supporting documentation at the producer level. The test results are not projectable to total reinsurance claim payments of $436 million in 1986 and $474 million in 1985. Our tests disclosed the following potential overpayments:

- $2 million of $8 million paid in 1986 for 96 reinsurance claims,
- $6.1 million paid in 1986 for the 1,189 drought claims filed on irrigated land,
- $1 million of $1.4 million paid in 1985 for 38 reinsurance claims, and
- $5.2 million paid in 1985 for the 993 drought claims filed on irrigated land.

Inspector general auditors selected another 96 reinsurance claims for 1986 totaling $9.2 million and found potential overpayments of $4.8 million. Their tests of $0.7 million of 15 reinsurance claims for 1985 showed potential overpayments of $0.5 million. The Corporation is currently examining the claims reviewed by us and by the inspector general auditors to confirm if overpayments were made, and, if so, to initiate collection action.

The Corporation's Standard Reinsurance Agreement, Form 456, as revised, states that the reinsured company may, consistent with sound insurance practices, settle any loss or claim. The potential overpayments disclosed by us and by the inspector general resulted from reinsured companies not thoroughly verifying the claims to ensure that program criteria such as eligibility and other requirements have been met. In addition, the Corporation receives only summary claims data from the reinsured companies which is not adequate to verify claims prior to payment. Finally, the Corporation does not have a program to verify claims on a postaudit basis.

In a management letter to the Corporation resulting from our 1985 audit, we recommended that the Corporation establish internal controls to assure itself of the accuracy of claims submitted. In August 1986, the Corporation established a compliance division to conduct postaudits of claims, but this division has been primarily responding to the allegations of informants, which leaves little time for systematic postaudits of claim payments.

The Corporation needs to implement an effective postaudit quality assurance program over claim payments to ensure that reinsured companies are adequately reviewing claims and to take appropriate action, ranging from administrative action to disbarment, when proper reviews are not conducted.

Additional analysis of the claims settlement process and our recommendations to the Corporation will be made in a separate report to be issued to the Chairman, House Subcommittee on Conservation, Credit, and Rural Development, Committee on Agriculture, who requested an examination of the claims settlement activities.

Accounting System Changes Needed for Financial Statement Preparation

The Corporation does not collect sufficient information in its accounting system to readily produce financial statements on a fiscal year basis in accordance with generally accepted accounting principles. As a result, the Corporation must make numerous adjustments and estimates to its crop year accounting basis that, although the best available at the time, can be inaccurate. This condition also affects the ability of the Corporation's system of internal accounting controls to generate accurate and timely financial statements from its original books of record.

Generally accepted accounting principles for casualty insurance companies, specifically, Financial Accounting Standards Board Statement No. 60, "Accounting and Reporting by Insurance Enterprises," require the Corporation to recognize (1) premiums, by spreading the premiums over the contract period or the period of risk, and (2) losses, including an estimate of losses incurred but not reported, in the period in which the event causing the loss occurs. Insurance companies are also required to amortize the direct cost of selling insurance on the same basis as the premium is recognized and to recognize loss adjustment costs in the same period in which the related losses are recognized. Reporting of these data occurs within the fiscal year of the entity.

The Corporation has difficulty producing financial statements that meet the insurance accounting standard. Its accounting system does not capture the date the loss occurred, and it also estimates losses by crop year rather than fiscal year, which causes numerous adjustments and estimates to be made in order to produce acceptable financial statements. This process can lead to inaccurate financial statements. For example, the Corporation's analysis of actual crop year 1984 losses showed the reported direct sales losses were off by $20 million because the estimates were based on crop year rather than fiscal year information.

The preparation of financial statements is further complicated by the Corporation's practice of allocating reinsurance premiums and losses from crop year to fiscal year based on an analysis of its direct insurance business. The reinsured companies do not submit a date of loss, and the Corporation must therefore allocate loss using its direct business experience, which, although similar, may not produce the same results. When this process began in 1984, the risk of material misstatements in the financial statements was not great because reinsurance for the previous 3-year analysis period was only 20 percent of the Corporation's total business. By 1986, however, its reinsurance business had grown to about 80 percent of its total business. Corporation officials state that all crop insurance functions will transfer to reinsured companies by 1992. Consequently, continuing to allocate reinsurance business by fiscal year on the basis of an analysis of the Corporation's past direct business could result in material misstatements of the financial statements.

We reported the above situation and the need for the Corporation to act on the problem in a July 19, 1985, management letter to the Corporation Manager, and again in a management letter dated June 20, 1986, addressed to the Corporation's Deputy Manager. As of April 15, 1987, corrective action has not been taken.

Recommendation

We recommend that the Corporation Manager and Comptroller obtain the date of loss from the reinsured companies and modify the accounting system to report losses on a fiscal year basis.

Agency Comment

We did not obtain written comments on this report. However, we did provide a draft of the report to appropriate Corporation officials, discussed its contents with them, and agreed to incorporate their oral comments into the report. The Comptroller of the Corporation stated:

"The Corporation concurs with the findings contained in the General Accounting Office's report on internal accounting controls. The Corporation is in the process of reviewing potential overpayments identified in the GAO and Inspector General examinations and determining amounts for collection efforts. Corporation auditors have been working closely with GAO and Inspector General auditors and are in the process of further testing to determine if additional overpayments exist. We agree that certain systems changes are needed to improve our financial reporting for conformance with FASB No. 60. This can be done in connection with other systems changes now under consideration and in process. At a minimum, we will endeavor to collect date of loss information for all claims paid."

Report on Compliance With Laws and Regulations

We have examined the financial statements of the Federal Crop Insurance Corporation for the years ended September 30, 1986 and 1985, and have issued our report thereon dated April 15, 1987. Our examinations were made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances. This report pertains only to our review of compliance with laws and regulations for the year ended September 30, 1986. (Our report on compliance with laws and regulations for the year ended September 30, 1985, is presented in GAO/AFMD-86-58, dated September 19, 1986.)

In our opinion, the Corporation 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 that caused us to believe that the Corporation was not in compliance with the terms and provisions of laws and regulations for other types of transactions not tested.

Financial Statements

Statement of Financial Condition

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF FINANCIAL CONDITION
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1986 AND 1985
(in thousands of dollars)

	FISCAL YEAR 1986		FISCAL YEAR 1985	
ASSETS				
Cash in U.S. Treasury (Note 4):				
Administrative Fund	$ 93,607		$ 95,609	
Insurance Program Fund	296,169	$389,776	33,300	$128,909
Accounts Receivable:				
Producer Premium	76,034		99,077	
Federal Subsidy	27,226		19,893	
Administrative & Other	4,048		1,293	
Less: Allowance for Doubtful Accounts	(3,425)	103,883	(3,425)	116,838
Advances to Reinsurance Accounts		11,808		0
Furniture and Equipment	3,377		3,082	
Less: Accumulated Depreciation	(1,037)	2,340	(775)	2,307
Total Assets		$507,807		$248,054
LIABILITIES AND EQUITY				
Liabilities:				
Accounts Payable:				
Estimated Losses	$104,835		$ 92,094	
Agent's Commission	8,258		14,257	
Loss Adjustment	1,759		94	
Reinsured Companies	53,641		183,950	
Contingent Liabilities-Litigation (Note 6)	8,080		0	
Administrative & Other	19,745		11,678	
Accrued Interest Payable (Note 5)	7,249		0	
Accrued Annual Leave	2,100		2,017	
Unearned Premium (Note 3)	159,469	$365,136	25,252	$329,342
Loans Payable to U.S. Treasury & CCC (Note 5)		563,000		113,000
Total Liabilities		928,136		442,342
Reserve for Contingencies (Note 6):				
Equity (Note 7):				
Capital Stock ($500,000 authorized) issued and outstanding	500,000		500,000	
Paid in Capital	37,978		37,978	
Accumulated Deficit	(959,152)		(738,058)	
Unexpended Appropriations	845		5,792	
Total Equity		(420,329)		(194,288)
Total Liabilities and Equity		$507,807		$248,054

The accompanying notes are an integral part of the statements.

Statement of Loss and Changes in Accumulated Deficit

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF LOSS AND
CHANGES IN ACCUMULATED DEFICIT
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1986 AND 1985
(in thousands of dollars)

	FISCAL YEAR 1986		FISCAL YEAR 1985	
REVENUES:				
Premiums Earned:				
Direct Sales	$80,644		$134,357	
Reinsurance premium-includes Puerto Rico	297,084	$377,728	324,288	$458,645
Interest Earned		5,295		5,905
Other		16		54
Total Revenues		383,039		464,604
EXPENSES:				
Insurance Losses:				
Direct Claims	154,544		211,890	
Reinsurance-includes Puerto Rico	436,057	590,601	474,300	686,190
Insurance Servicing Costs:				
Sales Agents' Commissions	12,125		19,822	
Reinsurance Administrative	69,751		79,570	
Reinsurance Loss Adjustment	19,691		28,016	
Loss Adjustment	4,669		9,393	
Losses/Other Prior Year Costs	11,866		(311)	
Bad Debts	1,665		31	
Interest Expense	10,554	130,321	366	136,887
Administrative:				
Personnel Compensation & Benefits	31,994		33,530	
Contractual Service	23,717		22,859	
Travel & Transportation	4,395		4,890	
Depreciation	262		234	
Other	8,084	68,452	6,985	68,498
Total Expenses		789,374		891,575
Loss from Operations		(406,335)		(426,971)
OTHER FINANCING SOURCES:				
Expended Operating Appropriations		185,241		205,298
Net Loss for Current Year		(221,094)		(221,673)
Accumulated Deficit, Beginning of Fiscal Year		(738,058)		(516,385)
Accumulated Deficit, End of Fiscal Year		($959,152)		($738,058)

The accompanying notes are an integral part of the statements.

Statement of Changes in Financial Position

FEDERAL CROP INSURANCE CORPORATION
STATEMENT OF CHANGES IN FINANCIAL POSITION
FOR FISCAL YEARS ENDED SEPTEMBER 30, 1986 AND 1985
(in thousands of dollars)

	FISCAL YEAR 1986	FISCAL YEAR 1985
SOURCE OF FUNDS		
Sale of Capital Stock (Note 7)	$ 0	$ 50,000
Loan Received from Treasury/CCC (Note 5)	450,000	113,000
Increase in Unearned Premium	134,217	(13,044)
Decrease in Accounts Receivable	12,955	45,961
Depreciation	262	234
Total Funds Received	597,434	196,151
APPLICATION OF FUNDS		
Net Loss for the Year	221,094	221,673
Purchase of Equipment	295	427
Advances to Escrow	11,808	0
Decrease in Unexpended Appropriations	4,947	(333)
Decrease in Accounts Payable	98,423	3,097
Total Funds Applied	336,567	224,864
Increase (Decrease) in Cash	$260,867	($28,713)
CHANGE IN CASH BALANCE:		
Cash, Beginning of Fiscal Year	$128,909	$157,622
Cash, End of Fiscal Year	389,776	128,909
Increase (Decrease) in Cash	$260,867	($28,713)

The accompanying notes are an integral part of the statements.

Notes to the Financial Statements

Notes to the Financial Statements

1. The Corporation

The Federal Crop Insurance Corporation (FCIC) was created on February 16, 1938 (7 U.S.C. 1501), and is a wholly owned government corporation within the U.S. Department of Agriculture. FCIC manages an all-risk crop insurance program to assist in stabilizing and protecting the farm sector of the nation's economy. The program was restricted in both geographic area and crops covered until the Federal Crop Insurance Act of 1980 (Public Law 96-365) called for improving the insurance program and expanding it nationwide to eventually phase out the disaster payment program. The Act calls for an actuarially sound, nationwide cost-sharing insurance program for agricultural producers to protect their production investment against unavoidable risks.

All-risk crop insurance was available in over 3,000 counties with policies covering 41 different commodities in 1986 and 40 in 1985.

2. Summary of Significant Accounting Policies

Accounting basis - FCIC maintains separate funds for the insurance program and for administrative support. However, for financial statement presentation purposes, the two funds are combined and are presented on the accrual basis of accounting following generally accepted accounting principles as applied to the casualty insurance industry.

Estimated losses - Losses are expensed based on incidents which have occurred and 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 - FCIC recognizes premium revenue proportionately over the crop insurance period. FCIC's risk of loss 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 normal harvest period. Premiums are generally collected at the end of the growing season when the crops are harvested.

Acquisition costs - FCIC includes 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 "Accounting and Reporting by Insurance Enterprises" requires insurance companies to capitalize and amortize prepaid acquisition costs in proportion to premium revenue recognized. As of year-end, FCIC did not have any prepaid acquisition costs.

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 on crop insurance written by the companies. In fiscal year 1986, FCIC had two reinsurance agreements: (1) its standard agreement with 47 companies to sell and service multiperil crop insurance, including an agreement with Puerto Rico, and (2) a modified agreement with one company to insure nursery stock. FCIC and the reinsured companies share 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 entitle the companies to 20 percent of the amount in the companies' reinsurance accounts, but not more than 5 percent of the book premium written by the companies for a 5-year period, for crop years 1981 to 1985. Crop year represents the period of time between planting date and completion of harvest. After 5 years, FCIC's and the reinsured companies' shares of reinsurance income were recalculated and amounts due to the companies were adjusted accordingly. As of September 30, 1986, FCIC had accumulated $981 thousand for payment to the reinsured companies. FCIC's reinsurance income, losses, administrative expenses, and loss adjustment expenses are accounted for on the same basis as FCIC uses for its direct business.

In 1986 FCIC began reimbursing companies on a reinsurance year basis. The reinsurance year covers three crop years for crops with sales closing dates between July 1 and June 30. Ultimate gain and/or loss sharing will be on a reinsurance year basis rather than the cumulative 5-year period adjustment.

Premium subsidy - FCIC includes premium subsidy received from appropriations in revenues in the fiscal year earned. Section 106(1) of the Federal Crop Insurance Act of 1980 directed FCIC to pay a portion of producers' premiums and provided appropriations for that purpose. 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 premium subsidy included in revenues was as follows:

	1986	1985
	---(millions)----	
Direct sales	$18.0	$30.0
Reinsurance	74.4	71.8
Total premium subsidy	$92.4	$101.8

Furniture and equipment - These assets are stated at acquisition cost or transferred value. Assets with a purchase price of $1,000 or greater and which have a useful life of over 1 year and improvements that extend the useful life of an asset are capitalized. FCIC uses the straight-line method of depreciating assets over their estimated useful service life of 10 years.

Employee benefits plans - Substantially all of FCIC's employees are covered by the Civil Service Retirement System, which is currently two-tiered. For employees hired prior to January 1, 1984, FCIC withholds approximately 7 percent of their gross earnings. Their contribution is then matched by FCIC and the sum transferred to the Civil Service Retirement Fund, from which this employee group will receive retirement benefits. For employees hired on or after January 1, 1984, FCIC withholds, in addition to Social Security withholdings, approximately 1.3 percent of their gross earnings, but matches such withholdings with a 7 percent contribution, as above. This second employee group will receive retirement benefits from the Civil Service Retirement System along with the Social Security system to which they currently contribute. For 1986 and 1985, FCIC contributed $1.6 million each year to the Civil Service Retirement System and $.9 million each year to the Social Security system. Although FCIC funds a portion of pension benefits under the Civil Service Retirement System relating to its employees and makes the necessary payroll withholding from them, it does not disclose the assets of the Civil Service Retirement System nor does it disclose actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. Reporting on such amounts is the responsibility of the U.S. Office of Personnel Management. Data regarding the Civil Service Retirement System's actuarial present value of accumulated benefits, assets available for benefits, and unfunded pension liability are not allocated to individual departments and agencies.

Appropriations - In addition to appropriations received for premium subsidies, 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 Changes in Financial Condition or the Statement of Loss and Changes in Accumulated Deficit. The Statement of Loss includes all funds that have been obligated and the related service or product constructively delivered. The Statement of Changes in Financial Condition includes obligated funds for undelivered orders.

Reclassification - Certain amounts in the 1985 financial statements were reclassified to conform to the 1986 presentation.

3. Change in Accounting Estimate

The Estimated Unearned Premium represents 1986 crop year premium recorded as a receivable but not recognized on the

Statement of Loss and Changes in Accumulated Deficit in fiscal year 1986. These premiums are reported on the Statement of Financial Condition for complete disclosure of all known financial events occurring in fiscal year 1986.

4. Cash

FCIC maintains separate funds for the insurance program and for administrative support. The administrative fund can only be used to pay administrative and operating costs of FCIC and cannot be used to pay producers' losses.

5. Loans Payable

On August 19, 1985, a promissory note was established between the Secretary of Agriculture and the Secretary of the Treasury under the borrowing authority granted by section 516(d) of the Federal Crop Insurance Act. The note allows the advance of no more than $113 million at any one time, with any outstanding balance on the note due January 1, 1988. Interest on the unpaid principal balance of each advance outstanding is payable semiannually on January 1 and July 1 of each year. The interest is payable at a rate equal to the current average market yield on outstanding marketable obligations of the United States of comparable maturities during the month preceding the issuance of such notes or obligations which averaged 8.875 percent. Interest does not accrue unless FCIC's cash balance with Treasury falls below $113 million. When this occurs, interest is calculated on a daily basis on the difference between $113 million and FCIC's cash balance.

To strengthen FCIC's financial position, the Congress, as part of the Food Security Act of 1985 (enacted December 23, 1985) reinstated FCIC's authority to use Commodity Credit Corporation (CCC) funds to pay producers' losses. On January 8, 1986, FCIC's Board of Directors approved a resolution to request that the Secretary of Agriculture borrow funds from CCC. As of September 30, 1986, FCIC had received $450 million from CCC. Interest is accrued on a monthly basis using CCC's monthly borrowing rate. As of September 30, 1986, $7.1 million was accrued. Although these funds have enabled FCIC to pay producers' losses and to reimburse reinsured companies for FCIC's share of the companies' losses, the additional funds have not improved FCIC's financial position. FCIC still faces financial difficulties in the future unless long-term solutions to improve its capital position are identified and implemented.

Subsequent events - P.L. 99-591 authorized the use of an additional $375 million of CCC funds. As of the statement date, no funds have been requested.

6. Contingent Liabilities

As of September 30, 1986, a number of lawsuits were outstanding against FCIC concerning disputes on claims. Although these lawsuits seek in excess of $107 million as filed, FCIC's legal counsel has advised the Corporation that its probable liability from said lawsuits is approximately $8 million, which has been recorded.

7. Equity

FCIC's operations since fiscal year 1981 have resulted in an accumulated deficit of $959 million as of September 30, 1986, and $738 million as of September 30, 1985, placing FCIC in a negative capital position. FCIC attributes this negative position primarily to adverse weather conditions. FCIC has made the Congress aware of its financial difficulties and has received additional funding authority to pay producer claims.

Section 101 of the Federal Crop Insurance Act of 1980 directed the cancellation of outstanding capital stock and increased the authorized amount of capital from $200 to $500 million. In accordance with the mandate of the Act, capital stock of $200 million was cancelled. As a result of this reorganization, cumulative expenses and the direct cost of loss adjustment paid from the insurance fund were written off and a balance of $38 million from the $200 million was recorded as contributed capital.

Section 110 of the Federal Crop Insurance Act of 1980 authorized the Secretary of Agriculture to use the funds of the CCC to pay FCIC losses if funds available to FCIC for that purpose were insufficient. The authority to use CCC funds expired one year from the date the authority was first used. During fiscal year 1981, FCIC used $250 million of CCC funds to reduce FCIC's accumulated deficit. The authority to use CCC funds expired on October 26, 1981.

As of September 30, 1986, FCIC has issued all authorized capital stock as follows:

	(millions)
P.L. 97-103, December 23, 1981	$250
P.L. 97-370, December 18, 1982	150
P.L. 98-396, August 22, 1984	50
P.L. 98-88, August 15, 1985	50
Total Stock Issued	$500

8. Contingent Recoveries

Information available as of the statement preparation date indicates that audits and reviews of reinsured companies by the

General Accounting Office, USDA Office of Inspector General, and the FCIC Compliance Division are finding a substantial number of potential overpaid indemnity payments. The reports are not concluded and the total amount is not known; however, preliminary indications are that the total amount will be material in relation to the financial statements. The overpaid amounts will be recorded as accounts receivable when the final determinations are made that they are valid amounts due FCIC.

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