

September 1990

FINANCIAL AUDIT

**Federal Crop
Insurance
Corporation's
Financial Statements
for 1989 and 1988**





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

Comptroller General
of the United States

B-114834

September 28, 1990

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

This report presents the results of our audits of the Federal Crop Insurance Corporation's financial statements for the fiscal years ended September 30, 1989 and 1988. Reports on the Corporation's internal control structure and on its compliance with laws and regulations are also provided.

The Corporation continues to suffer losses, due to claims and administrative costs exceeding premiums, which will result in the need for additional government capital to sustain operations. Claims have exceeded premiums every year since enactment of the Federal Crop Insurance Act of 1980, with 1989 losses amounting to \$548 million. The Corporation's 1989 accumulated deficit amounts to \$2.6 billion, which has been financed primarily by transfers of \$2.3 billion from the Commodity Credit Corporation.

Without significant changes in its insurance program operations, the Corporation's ability to meet its obligations will depend on continuing government assistance. The administration's 1991 budget proposal recommended the termination of Federal Crop Insurance Program effective with the 1991 crop year. The Congress is currently debating this issue.

As discussed in more detail later in our report, the 1989 audit disclosed three reportable conditions regarding (1) the Corporation's oversight of reinsured companies, (2) controls over processing and payment of administrative expenses, and (3) financial reporting systems and procedures.

Background

The Federal Crop Insurance Corporation is a wholly-owned government corporation within the Department of Agriculture (USDA). The Corporation manages a multi-peril crop insurance program intended to stabilize and protect U.S. farm producers. The program was expanded by the Federal Crop Insurance Act of 1980 from a localized program covering only a few crops to a national program covering over 50 different crops in over 3,000 counties. The 1980 act also authorizes the Corporation to develop an actuarially sound system of insurance so that the premiums will cover claims plus build a reserve to provide for large or unusual claims in the future.

fairly its financial position as of September 30, 1989, and the results of its operations and its cash flows for the fiscal year then ended, in conformity with generally accepted accounting principles.

Material Internal Control Weaknesses Persist

Arthur Andersen's report on internal control structure, with which we concur, discusses three reportable conditions, two of which were considered to be material weaknesses which could result in additional losses to the Federal Crop Insurance Corporation. These conditions were considered during the audit and do not affect the opinion expressed on the fair presentation of the Corporation's financial statements.

Oversight of Reinsured Companies

Although a continuing material weakness, the Corporation's oversight of reinsured companies' loss adjustment activities has improved. As discussed later in this report, the percent of claims involving overpayments has been declining, according to our reports and one by the USDA Office of Inspector General. The Compliance Division, which was established in 1986, contributed to the reduced overpayment rates by monitoring reinsured companies' compliance with Corporation standards, particularly those pertaining to loss adjustments. However, Arthur Andersen reported that frequent and more timely reviews of reinsured companies by the Compliance Division would increase its effectiveness. The oversight issue was identified as a material weakness in our 1988 report on internal controls.

The Compliance Division is scheduling additional resources to conduct a review of all reinsured companies every 15 to 18 months and is expanding its areas of coverage to correct this weakness.

Processing and Payment of Administrative Expenses

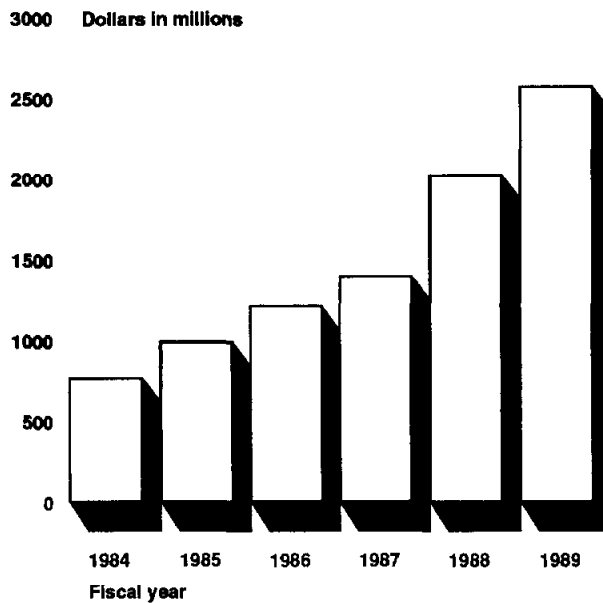
During 1989, the Corporation did not have effective internal controls over the processing and payment of \$61 million of certain administrative expenses. As discussed later in this report, the Corporation had not established internal accounting control procedures to ensure that all transactions sent to the Department of Agriculture's National Finance Center (NFC) in New Orleans were accurately processed and recorded. This issue was also identified as a material weakness in our 1988 report on internal accounting controls.

Arthur Andersen was able to verify that transactions were properly supported and that the related amounts were accurately reported in the financial statements by (1) obtaining computer tapes from NFC showing

The Deficit Has Grown Steadily Since 1984

Since 1984, the Corporation's accumulated deficit has increased over 3 times from \$766 million to \$2.6 billion in 1989. (See figure 1.)

Figure 1: Accumulated Deficit for Fiscal Years 1984 Through 1989



This increasing deficit was caused by a significant shortfall of crop insurance premiums needed to fund insurance claims and administrative expenses. The deficit primarily has been financed by \$2.3 billion in funding for insurance losses provided by the Commodity Credit Corporation. The remaining \$0.3 billion was funded from capital stock and U.S. Treasury borrowings. The program's worst financial performance was in 1988, when the program paid out almost 2-1/2 times more in claims than it collected in premiums. (See figure 2.) During the period 1984 through 1989, program losses added \$1.8 billion to the Corporation's cumulative deficit.

50 percent by 1985. The amount of eligible acres enrolled in crop insurance rose from 9.6 percent in 1980 to 24.5 percent in 1988. Participation rates rose to about 40 percent in 1989 in response to the severity of the 1988 drought and requirements that some disaster assistance recipients must purchase crop insurance.

Continued Disaster Payments Decrease Participation

The Congress passed the 1980 act anticipating that the insurance program would eventually replace disaster payments to farmers. However, disaster assistance continues through direct payments and emergency loan programs because producers believe that in times of widespread crop failures the Congress will approve disaster relief payments.

In response to concerns about the plight of the Corporation, the Congress established the Commission for the Improvement of the Federal Crop Insurance Program in 1988. The Commission's objective was to find ways to lessen, if not eliminate, the need for disaster payments, while providing producers more equitable, efficient, and predictable protection from natural disasters. The Commission completed its study in 1989 and recommended broadening farmer participation, improving responsiveness to farmers' needs, simplifying the program, and improving program administration.

In its 1990 farm bill proposal, the administration recommended replacing crop insurance with disaster payments. These activities by the Congress and the administration reflect the conflict over how best to provide disaster assistance because the promise of disaster payments is viewed as incompatible with a viable crop insurance program requiring producers to pay premiums.

In September 1989¹ and March 1990,² we took the position that a well-designed and well-managed crop insurance program can provide disaster assistance more equitably and efficiently than the emergency loan and direct payment disaster programs.

¹Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, September 20, 1989).

²Roles, Cost, and Criteria for Assessing Agriculture Disaster Assistance Programs Between 1980 and 1988 (GAO/T-RCED-90-37, March 6, 1990).

administrative costs based upon a fixed percentage of the premium, which includes the reinsured companies' actual administrative and claims adjustment costs, plus profit.

Higher reinsurance costs have also resulted from overpayments of claims by reinsured companies which have cost the Corporation millions of dollars. This was caused by (1) reinsured companies having the authority to settle claims on policies they had sold and (2) a lack of adequate monitoring of reinsurance activities by the Corporation.

In 1987, we reported that in a sample of selected claims for the 1984 and 1985 crop years, about 31 percent of the claims amount was overpaid by reinsured companies.³ This compared to a 1 percent overpayment rate on a sample of direct business claims settled by the Corporation. Subsequent reviews by us and one by the USDA Office of Inspector General focused on claims adjusted by reinsured companies for crop years 1987 and 1988 and found that some improvements had been made. For crop year 1987, we reported that the reinsured companies' overpayment rate was about 16 percent.⁴ The Inspector General reviewed crop year 1988 claims and found that the overpayment rate was about 13 percent.⁵ Despite these improvements in overpayment rates, the Inspector General estimated that nationwide overpayments on corn, soybeans, and wheat reinsured claims amounted to about \$80 million in 1988. As discussed in this year's report on internal control structure, the Corporation's Compliance Division is making efforts to strengthen its monitoring of reinsured companies to help reduce claims overpayment.

Comments of Cognizant Officials

We provided a draft of this report to responsible Corporation officials for comment. They concurred with the contents and indicated their commitment to correct the problems noted.

During the course of its audit, Arthur Andersen also identified several matters which, although not material to the financial statements, are being communicated for the Corporation's consideration in a separate management letter.

³Crop Insurance: Overpayment of Claims by Private Companies Costs the Government Millions (GAO/RCED-88-7, November 20, 1987).

⁴Crop Insurance: Private Company Loss Adjustment Improving, but Overpayment Still High (GAO/RCED-90-32, November 7, 1989).

⁵Federal Crop Insurance Corporation Crop Year 1988 Insurance Contracts With Claims, USDA Office of Inspector General, Audit Number 05600-1-Te, September 1989.

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this budget proposal includes only carryover obligations from the prior crop year and a small amount of 1991 administrative obligations. The proposed budget for fiscal year 1991 also includes alternative amounts reflecting funding under the current law. Until Congress adopts, and the President signs, the Agriculture appropriations bill for fiscal year 1991, Federal Crop Insurance Corporation's Board of Directors is conducting normal operations.

Arthur Andersen & Co.

Kansas City, Missouri,
April 13, 1990

**Auditors' Report on Internal
Control Structure**

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For all of the internal control structure categories listed above, we obtain an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

We consider the following matters noted during the course of our audit to be reportable conditions:

1. OVERSIGHT OF REINSURED COMPANIES

Observations and Findings-

Federal Crop Insurance Corporation Compliance Division performs periodic reviews of reinsured companies, sales and service contractors and the Corporation's Field Service offices to evaluate compliance with contract provisions. The Comptroller Division performs periodic financial reviews of reinsured company activity. In general, the Corporation's reviews have historically been infrequent and not always completed on a timely basis. As such, the effectiveness of the reviews are diminished.

We suggest financial and compliance reviews of reinsured companies be performed on a regular, frequent basis. These reviews should be comprehensive, and should be completed and results communicated on a timely basis. Also, all corrective actions required of the reviewed party should be monitored to ensure implementation in a timely manner.

Management's Response-

Agree. The Compliance Division enhanced its review scheduling process during fiscal year 1989 to include a review of each reinsured company, sales and service contractor and Corporation Field Service office every 15-18 months. The Compliance Division review procedures were also expanded to cover additional areas of the review entities' operations, among other things. Staffing changes were made to provide resources for implementation of these Compliance Division changes.

The Comptroller Division is in the process of revising the scheduling and format for financial reviews of reinsured companies to improve coverage of reinsured company business and timeliness of the reviews.

Auditors' Report on Internal
Control Structure

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Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. In our opinion, we believe the following reportable conditions, which were also identified by the General Accounting Office (GAO) in their 1988 audit of the Corporation, to be material weaknesses:

1. The Corporation needs to strengthen its oversight of reinsured companies. The Corporation has made improvements as indicated by the establishment of the Compliance Division to monitor reinsured company activities. However, the 1989 and 1988 analyses performed by GAO and U.S. Department of Agriculture Office of Inspector General, respectively, indicated that the Compliance Division reviews did not provide a reliable basis for conclusions about the overall quality and acceptability of reinsured company loss adjustment practices.

This weakness was identified in previous audit reports based on the special studies described above, which were performed apart from the audit process. Although the Comptroller and Compliance Divisions implemented changes to address this weakness, these changes were not in place throughout fiscal year 1989, and no further studies have been performed which would permit us to assess the effectiveness of the changes and, therefore, the current status of reinsured company loss adjustment practices. As a result, we did not note sufficient improvement in the Corporation oversight during the period under audit to allow us to remove this item from material weakness status.

2. The Corporation does not have sufficient internal controls over the processing and payment of administrative expenses. Specifically, the Corporation has not established internal accounting control procedures to ensure that all transactions sent to the U.S. Department of Agriculture National Finance Center in New Orleans were accurately processed and recorded.

These matters were considered by us during our audit and do not modify the opinion expressed in our auditors' report dated April 13, 1990.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of Federal Crop Insurance Corporation in a separate letter.

This report is intended for the information of the board of directors, management and Congress. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Kansas City, Missouri,
April 13, 1990

Arthur Andersen & Co.

Financial Statements

Statements of Financial Position

AS OF SEPTEMBER 30, 1989 AND 1988
(in thousands of dollars)

ASSETS

	1989	1988 (Restated and Reclassified)
CURRENT ASSETS:		
Cash (Note 4)-		
Administrative Fund	\$ 68,074	\$ 88,165
Insurance Fund	995,470	1,360,482
	<u>1,063,544</u>	<u>1,448,647</u>
Accounts receivable-		
Reinsured companies	469,417	237,853
Producers, net of allowance for uncollectible accounts of \$8,000 in 1989 and \$11,000 in 1988	49,090	32,397
Administrative and other	1,838	504
	<u>520,345</u>	<u>270,754</u>
Total current assets	<u>1,583,889</u>	<u>1,719,401</u>
FURNITURE AND EQUIPMENT, net of accumulated depreciation of \$2,258 in 1989 and \$1,977 in 1988 (Note 2)	778	703
Total assets	<u>\$ 1,584,667</u>	<u>\$ 1,720,104</u>

LIABILITIES AND EQUITY

CURRENT LIABILITIES:		
Claims payable (Note 2)	\$ 788,083	\$ 837,789
Reinsured companies (Note 2)	128,554	60,388
Sales and service contractors' commissions (Note 2)	9,761	7,956
Accrued claims adjustment contractors' costs (Note 2)	4,580	4,402
Underwriting gains due reinsured companies (Note 2)	28,000	-
Administrative and other (Notes 2 and 11)	15,927	14,028
Unearned premium (Note 3)	130,896	71,074
Unearned premium subsidy appropriation (Note 3)	87,742	181,080
Total current liabilities	<u>1,193,543</u>	<u>1,176,717</u>
LOAN PAYABLE TO U.S. TREASURY (Note 5)	113,000	113,000
RESERVE FOR LITIGATION (Note 6)	1,000	6,100
Total liabilities	<u>1,307,543</u>	<u>1,295,817</u>
EQUITY:		
Capital stock (Note 7)	500,000	500,000
Paid-in capital (Note 7)	37,978	37,978
Donated capital (Note 8)	2,300,000	1,900,000
Invested capital (Note 2)	778	703
Accumulated deficit	(2,566,806)	(2,019,035)
Unexpended appropriations	5,174	4,641
Total equity	<u>277,124</u>	<u>424,287</u>
Total liabilities and equity	<u>\$ 1,584,667</u>	<u>\$ 1,720,104</u>

The accompanying notes are an integral part of these statements.

Financial Statements

Statements of Cash Flows

FOR FISCAL YEARS ENDED SEPTEMBER 30, 1989 AND 1988

Increase (Decrease) in Cash
(in thousands of dollars)

	<u>1989</u>	<u>1988</u>
		(Reclassified)
CASH FLOW FROM OPERATING ACTIVITIES:		
Net loss transferred to accumulated deficit	\$ (547,771)	\$ (626,124)
Adjustments to reconcile net loss transferred to accumulated deficit to net cash inflow (outflow) from operations-		
Depreciation expense	268	249
Net additions of furniture and equipment	(343)	(32)
Allowance for uncollectible accounts	(3,000)	(9,000)
Increase in receivable from reinsured companies	(231,564)	(29,228)
(Increase) decrease in receivable from producers	(13,693)	12,665
(Increase) decrease in administrative and other receivables	(1,334)	972
Increase (decrease) in claims payable	(49,706)	544,317
Increase in accrued claims adjustment contractors' costs and sales and service contractors' commissions	1,983	5,321
Increase in payable to reinsured companies	68,166	16,703
Increase (decrease) in administrative and other liabilities	1,899	(17,275)
Increase (decrease) in underwriting gains due reinsured companies	28,000	(16,893)
Increase in unearned premium	59,822	12,220
Increase (decrease) in unearned premium subsidy appropriation	(93,338)	121,143
Decrease in reserve for litigation	(5,100)	(1,900)
Increase in unexpended appropriations	533	2,057
Total adjustments to net loss	(237,407)	641,319
Net cash inflow (outflow) from operations	(785,178)	15,195
CASH FLOW FROM INVESTING ACTIVITIES:		
Cash inflows (outflows)-		
Net investment in (retirement of) contributed furniture and equipment	75	(217)
Net cash inflow (outflow) from investing activities	75	(217)
CASH FLOW FROM FINANCING ACTIVITIES:		
Cash inflows-		
Receipts of donated capital from the Commodity Credit Corporation (Note 8)	400,000	900,000
Net cash inflow from financing activities	400,000	900,000
Net increase (decrease) in cash	(385,103)	914,978
Cash balance, beginning of fiscal year	1,448,647	533,669
Cash balance, end of fiscal year	\$1,063,544	\$1,448,647

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

SEPTEMBER 30, 1989 AND 1988

1. ORGANIZATION

The Federal Crop Insurance Corporation (FCIC) was established with the Federal Crop Insurance Act (the Act), which was enacted as Title V of the Agricultural Adjustment Act of 1938 (52 Statute 72). FCIC manages a multiple-peril crop insurance program to assist in stabilizing and protecting the farm sector of the nation's economy. The program was restricted until the Federal Crop Insurance Act of 1980 (Public Law 96-365) expanded the program nationwide to eventually phase out the disaster payment program which was authorized by the Agriculture Act of 1949, as amended. Crop insurance under this program is available in over 3,000 counties with policies covering 50 different commodities.

FCIC is a wholly-owned government corporation within the United States Department of Agriculture (USDA), under the direction and control of a board of directors. The board of directors is appointed by the Secretary of Agriculture. The accompanying financial statements include only those operations under the control of the board of directors.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

FCIC maintains separate accounts for the insurance program and for administrative support. However, for financial statement presentation purposes, the two sets of accounts are combined and are presented on the accrual basis of accounting following generally accepted accounting principles.

Revenue Recognition Including Federal Premium Subsidy

Premiums (including premium subsidies) are recognized as earned during a fiscal year based on a pro rata amount with respect to each crop's growing season. The portion of premium not recognized during the fiscal year is classified as unearned. FCIC's risk of loss commences when the crop is planted and continues through the respective growing season until the crop is harvested, destroyed or otherwise removed from the field. Premiums are generally collected at the end of the growing season when the crops are harvested. A provision is made for federal premium amounts expected to be uncollectible based on historical experience. Under the standard reinsurance agreement, collection of premiums on reinsured company business is the responsibility of the reinsured company.

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Reinsurance Administrative
Expenses and Payables

Section 508(e) of the Act, as amended, authorizes FCIC to enter into reinsurance agreements with private insurance companies. Under these agreements, FCIC assumes the majority of the risk of loss on crop insurance written by the reinsured companies.

The 1989 and 1988 standard reinsurance agreements provided for both proportional and nonproportional means by which the reinsured may cede business to FCIC. The reinsured company elects the methods by which it intends to transfer risk to FCIC through its plan of operation. The plan of operation becomes a part of the reinsurance agreement for each reinsurance year (July 1 through June 30).

Proportional reinsurance provides for a one-to-one percentage exchange of losses and premium between the reinsured company and FCIC. A reinsured company may not cede to FCIC, under the proportional methods, premium that exceeds 70 percent of its total book of business for the 1989 reinsurance contract year and 57 percent for the 1988 contract year. Nonproportional reinsurance refers to mandatory stop loss provisions which apply to the reinsured's entire retained book of business after the cessions made under proportional methods. Stop loss reinsurance may be applied on both a state and national level based upon the ratio of the reinsured's retained ultimate net losses to its retained net book premium. Limitations under stop loss reinsurance are dependent upon the business retained and the ratio of losses to premium.

Premiums and losses are reported monthly under the standard reinsurance agreement and an annual settlement is calculated whereby the results of the business written by the reinsured companies are determined and an experience-rated underwriting gain or loss is computed. Underwriting gains are paid to the reinsured companies by FCIC at the annual settlement date, while underwriting losses are paid by reinsured companies to FCIC with the monthly accounting reports. In fiscal year 1989, the computation resulted in a net underwriting gain of \$28 million, which was reflected by FCIC as a liability as of September 30, 1989. Additional underwriting gains of \$3.7 million related to 1988 and prior years were recorded and paid during fiscal year 1989, resulting in total underwriting gains to reinsured companies of \$31.7 million for fiscal year 1989.

The standard reinsurance agreements provided for reinsurance administrative expenses totaling 36.5 percent of reinsurance premium in 1989 and 37.0 percent in 1988. The 1989 and 1988 reinsurance agreements included an expense reimbursement equal to 34 percent of premium plus expense reimbursement for premium taxes (about 2 percent of premium) on policies reinsured under the agreement. The agreements also provided additional reimbursements for claim expenses, ranging from .02 percent of premium to 1 percent of premium, depending on the severity of the aggregate loss ratio. This provision

3. PREMIUM AND FEDERAL PREMIUM SUBSIDY

There was a substantial increase in FCIC's direct and reinsured gross premium volume from \$423 million in fiscal year 1988 to \$760 million in fiscal year 1989. The increase was predominately attributable to the following factors:

- o Price elections (guaranteed crop prices) for crop year 1989 increased by approximately 20 percent, primarily due to the effect of the drought experienced in 1988. Producer premiums are based in part on price elections.
- o The Disaster Assistance Act of 1988 required uninsured producers to purchase all-risk crop insurance for the 1989 crop year in order to receive disaster payments.
- o Additional producers purchased all-risk crop insurance, largely due to the cumulative effect of recent drought conditions and continuing drought forecasts.

Section 508(b)(3) of the Act, as amended, requires FCIC to pay up to 30 percent of each producers' premium on coverage elections up to 65 percent of recorded or appraised average yield and a reduced subsidy on elections in excess of 65 percent of the applicable average yield. The coverage elections made by producers resulted in an overall average subsidy rate of approximately 25 percent of total premium for 1989 and 1988. FCIC receives a premium subsidy appropriation to provide funds for this subsidy. The premium subsidy is recognized as revenue in the same manner as premium paid by the producer. Premium subsidy included in the statement of loss was \$191 million in fiscal year 1989 and \$104 million in 1988.

A summary of earned and unearned premium, showing both producer premium and the premium subsidy, is shown in the following table for fiscal years 1989 and 1988 (in thousands of dollars):

	Fiscal Year	
	----- 1989	1988 -----
Earned Premium:		
Producer	\$538,094	\$318,910
Subsidy	190,545	104,131
Total	----- \$728,639	----- \$423,041
	-----	-----
Unearned Premium:		
Producer	\$ 97,790	\$ 53,300
Subsidy	33,106	17,774
Total	----- \$130,896	----- \$ 71,074
	-----	-----

6. RESERVE FOR LITIGATION

FCIC is a defendant in various litigation arising in the normal course of business. Damages claimed in such litigation exceed \$80 million. However, management does not believe the impact of settlement of these cases to be material. A \$1 million reserve for settlement of litigation has been provided as of September 30, 1989.

Potential overpayments to reinsured companies of approximately \$8.8 million in fiscal year 1989 and \$6 million in 1988 have been identified by the Office of Inspector General, the General Accounting Office and the FCIC Compliance Division. These overpayments represent potential revenue if collection is ultimately made. However, these claims are subject to rebuttal and appeal by the reinsured companies, and collections subsequent to September 30, 1989, have been immaterial. Realization of this revenue is subject to considerable uncertainty and, accordingly, no receivables have been included in the financial statements for fiscal years 1989 or 1988.

7. CAPITAL STOCK AND PAID-IN CAPITAL

Section 504(a) of the Act, as amended, directs and authorizes capital stock of \$500 million subscribed by the United States of America. There has been no change in capital stock issued since August 15, 1985. As of September 30, 1989, FCIC has issued all authorized capital stock as follows (in millions of dollars):

<u>Public Law</u>	<u>Issued</u>	<u>Amount</u>
97-103	December 23, 1981	\$250
97-370	December 18, 1982	150
98-396	August 22, 1984	50
99-088	August 15, 1985	50

		\$500

Unexpended Balance of Original Stock Issue

The Federal Crop Insurance Act of 1980 directed the Secretary of the Treasury to cancel the original \$200 million of outstanding capital stock of the Corporation. Cumulative expenses of \$162 million were written off against the original amount of capital stock leaving \$38 million which was transferred to paid-in capital in fiscal year 1981.

8. DONATED CAPITAL

Restatement of Transfers From the
Commodity Credit Corporation (CCC)

Section 110 of the Federal Crop Insurance Act of 1980 authorized the Secretary of Agriculture to use the funds of the CCC, a government corporation within

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plan, an employee may contribute (tax deferred) up to 10 percent of salary to an investment fund. The government then matches this amount up to 5 percent. Those employees electing to remain under CSRS will receive benefits now in place, and may also contribute (tax deferred) up to 5 percent of their salary to the thrift plan, with no matching amount contributed by the government. FCIC also pays a portion of the cost of employee life and health insurance. FCIC contributed a total of \$4.6 million for employee benefits in fiscal year 1989 and \$3.9 million in fiscal year 1988.

The value of vested and nonvested benefits, assets available for benefits, and unfunded pension cost related to FCIC employees cannot be determined as this is a multiemployer plan. Although FCIC funds a portion of pension benefits under the CSRS relating to its employees and makes the necessary payroll withholdings, it does not disclose the assets of the CSRS, nor does it disclose actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. Reporting of such amounts is the responsibility of the U.S. Office of Personnel Management.

10. LEASE COMMITMENTS

FCIC has entered into operating lease agreements for certain of its office facilities. Total rent expense amounted to \$730,000 in fiscal year 1989 and \$545,000 in fiscal year 1988. In addition, the USDA incurred rents on behalf of FCIC totaling \$943,000 in fiscal year 1989 and \$1,300,000 in fiscal year 1988. These rental costs were absorbed by USDA and, therefore, are not reflected in the accompanying statements.

11. COMMISSION FOR THE IMPROVEMENT OF THE FEDERAL CROP INSURANCE PROGRAM

During 1988, the United States Congress enacted the Federal Crop Insurance Commission Act of 1988, which established an advisory panel to study the Federal Crop Insurance program. Under the statute, the commission was specifically charged with the responsibility of studying the program and recommending improvements. At September 30, 1989, the Commission had received \$600,000 of the \$1.5 million made available under this statute. The remaining \$900,000 is included in administrative and other liabilities on the accompanying statement of financial position.

12. PROGRAM CONTINUANCE

Since the enactment of the Federal Crop Insurance Act of 1980, the FCIC has incurred significant losses from operations, due primarily to the inadequacy of premiums to cover policyholders' losses, and has an accumulated deficit of approximately \$2.6 billion at September 30, 1989. The FCIC has relied on additional funding from CCC and U.S. Treasury borrowings to meet its obligations. Without significant changes in insurance program operations, the FCIC will likely continue to suffer significant losses and require additional assistance from CCC or other sources of Congressional funding.

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On January 30, 1990, the Administration released its 1991 budget proposal which, among other things, proposed termination of funding for the Federal Crop Insurance program effective with the 1991 crop year. Funding for 1991 under this budget proposal includes only carryover obligations from the prior crop year and a small amount for 1991 administrative obligations. The proposed budget for 1991 also includes alternative amounts reflecting funding under the current law. Until Congress adopts, and the President signs, the 1991 Agriculture appropriations bill, the FCIC Board of Directors is conducting normal operations.

the USDA, to pay FCIC losses if funds available to FCIC for that purpose were insufficient. Under this authority \$250 million of CCC funds were transferred to FCIC during fiscal year 1981 to pay losses. This transfer of funds was originally recorded as income during fiscal year 1981. To more appropriately reflect the nature of this transfer and to be consistent with the treatment of subsequent CCC transfers, the balances of donated capital and retained deficit as of September 30, 1987, in the accompanying statements have been restated to reflect the 1981 CCC transfers as donated capital.

Transfers of Funds From CCC

At September 30, 1986, FCIC owed CCC \$450 million for funds advanced. In September 1987, the \$450 million was designated by USDA as nonreimbursable, and consequently has been classified as donated capital. Total donated capital has been received from CCC as shown in the following summary (in millions of dollars):

<u>Summary of Donated Capital</u>		<u>Amount</u>
September 30, 1981	CCC transfer	\$ 250
September 30, 1986	CCC transfer	450
September 30, 1987	CCC transfer	300
September 30, 1988	CCC transfer	900
	Balance September 30, 1988	----- 1,900
September 30, 1989	CCC transfer	400
	Balance September 30, 1989	----- \$2,300 =====

9. EMPLOYEE BENEFITS

The majority of FCIC's employees are covered by the Civil Service Retirement System (CSRS), which is currently two-tiered. For employees hired prior to January 1, 1984, FCIC withholds approximately 7 percent of their gross earnings, which is matched by FCIC. The amount withheld from employees is then remitted to the Civil Service Retirement Fund. 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. This second employee group will receive retirement benefits from the CSRS along with the Social Security System to which they currently contribute. By December 31, 1987, each employee covered by the CSRS made a decision to remain under the CSRS or transfer to the new Federal Employees Retirement System (FERS).

Under FERS, employees will receive retirement benefits from Social Security, a government retirement benefit of 1 to 1.1 percent of "high-3" salary base and benefits from a defined contribution plan (thrift). Under the contribution

Financial Statements

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A reconciliation of the unearned premium subsidy appropriation is shown in the following table for fiscal years 1989 and 1988 (in thousands of dollars):

	Fiscal Year	
	----- 1989	1988 -----
Beginning balance, October 1	\$ 181,080	\$ 59,936
Appropriation received	112,000	228,523
	-----	-----
Subtotal	293,080	288,459
Fiscal year earned subsidy income	(190,545)	(104,131)
Net increase in subsidy transferred to unearned premium	(14,793)	(3,248)
	-----	-----
Ending balance, September 30	\$ 87,742	\$ 181,080
	-----	-----

Since 1981, FCIC has received a total of \$978 million in appropriations for premium subsidy, of which \$890 million has been recognized as of September 30, 1989.

4. CASH IN UNITED STATES TREASURY

FCIC maintains separate accounts for administrative support and for the Insurance Fund. The administrative account can only be used to pay administrative and operating costs of FCIC as well as program expenses, and cannot be used to pay losses. The Insurance Fund is used to pay losses and can also be used to pay certain administrative expenses if the operating appropriation is not adequate to cover these costs. The Corporation does not earn interest on cash maintained in these Treasury accounts.

5. LOAN PAYABLE TO UNITED STATES TREASURY

On August 19, 1985, a promissory note was executed between the Secretary of Agriculture and the Secretary of the Treasury under the borrowing authority granted by section 516(d) of the Act. The note allowed the advance of no more than \$113 million, with the outstanding balance originally due January 1, 1988. In October 1987, the due date of the note was extended to January 1, 1990, and further extended to January 1, 1992 on December 20, 1989.

Interest on the unpaid principal balance outstanding is payable semiannually on January 1 and July 1 at a rate equal to the current average market yield on outstanding obligations of the United States of comparable maturities during the month preceding the issuance of such notes or obligations. Interest, however, does not accrue unless FCIC's cash balance in the Insurance Fund 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. No interest expense was incurred during fiscal years 1989 and 1988 as FCIC's cash balance with Treasury did not fall below \$113 million.

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resulted in an additional reimbursement of .5 percent of premium in 1989 and 1 percent in 1988. Total reinsurance administrative expenses were \$266 million and \$155 million for fiscal years 1989 and 1988, respectively, of which \$129 million and \$60 million was shown as a payable to reinsured companies at September 30, 1989 and 1988, respectively.

Operating Appropriations

In addition to the annual appropriation for premium subsidy, FCIC also receives an annual appropriation for administrative, operating, reinsurance administrative and other program expenses, except for uncollectible accounts and interest expense.

The administrative appropriation is intended to cover substantially all expenses other than losses incurred, the provision for uncollectible accounts and interest expense. When the administrative appropriation is sufficient to cover applicable expenses, the Corporation's accounting policy is to prorate the appropriation between fiscal years as premiums are earned. However, in fiscal years 1989 and 1988, the administrative appropriation was not adequate to cover actual obligations. Excess expenses of \$147 million and \$14 million not covered by appropriation have been reported in the statements of loss for the fiscal years ended September 30, 1989 and 1988, respectively. These expenses have been paid out of the Insurance Fund. All administrative and program expenses have been reported in the fiscal years incurred as a result of the premium deficiencies which existed.

Depreciation of Furniture and Equipment and Invested Capital

Depreciation expense of \$268,000 and \$249,000 was recorded in fiscal years 1989 and 1988, respectively. Furniture and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets, ranging from five to nine years. Invested capital is recorded at the cost of furniture and equipment acquired, as all furniture and equipment purchases are paid for through the annual operating appropriation at the time of purchase. Invested capital is decreased by the amount of depreciation and asset retirements during a fiscal year.

Administrative and Other

The liability for administrative and other expenses includes \$2.2 million for accrued annual leave for fiscal year 1989 and \$2.1 million for 1988. This amount is not administratively funded by current appropriation from Congress.

Reclassification of Prior Year Amounts

Certain reclassifications have been made to the fiscal year 1988 financial statements to conform to the classification used in fiscal year 1989.

Claims Recognition

Liabilities for claims payable and related claims adjustment expenses are established using estimates of incurred but unpaid claims based on historical experience, adjusted for changes in crop growing conditions. Since the calculations of claims payable and claims adjustment expenses payable are necessarily based on estimates, the ultimate liabilities may be more or less than the estimates.

Sales and service contractors' commissions, claims adjustment expenses and reinsurance administrative expenses are usually covered by operating appropriations; however, these expenses may be paid in part from insurance program funds if appropriated funds are not sufficient to pay these expenses. Indemnity losses are paid from premium proceeds, including premium subsidy, and Commodity Credit Corporation (CCC) transfers.

In fiscal years 1989 and 1988, because claims incurred exceeded the premium earned, a premium deficiency existed as defined in the Statement of Financial Accounting Standards No. 60 "Accounting and Reporting by Insurance Enterprises" (SFAS 60). The aggregate loss ratio for 1989 was approximately 1.5 (\$1.50 of claims for every \$1.00 of premium, approximately 25 percent of which is a federal subsidy and 75 percent of which is paid by the producer) and approximately 2.5 for 1988. Accordingly, all anticipated claims, claims adjustment expenses and acquisition costs in excess of unearned premiums to which they relate at September 30, 1989 and 1988, were recognized in the fiscal year incurred.

Acquisition Costs

FCIC includes only sales and service contractors' 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. SFAS 60 requires insurance companies to capitalize and amortize acquisition costs in proportion to premium revenue recognized. However, as a result of the premium deficiencies which existed in fiscal years 1989 and 1988, all acquisition costs related to contracts sold during those years were recognized in the year sold and no costs were deferred to subsequent periods.

Sales and Service Contractors' Commissions

The standard sales and service contractor agreements for 1989 and 1988 provided for a commission rate of 20 percent of premiums. The Disaster Assistance Act of 1988 provided for a reduction of commissions paid on contracts sold in 1989 as a result of the mandatory insurance requirement of the Act. FCIC determined the amount of this reduction should equal 3 percent of premiums. This resulted in an overall effective rate of approximately 19.8 percent of premium for 1989 crop year sales and service contractors' commissions.

Financial Statements

Statements of Equity

FOR FISCAL YEARS ENDED SEPTEMBER 30, 1989 AND 1988
(In thousands of dollars)

	<u>Capital Stock</u>	<u>Paid-In Capital (Restated)</u>	<u>Donated Capital (Restated)</u>	<u>Invested Capital</u>	<u>Accumulated Deficit (Restated)</u>	<u>Unexpended Appropriations</u>	<u>Total Equity</u>
BALANCE, September 30, 1987	\$500,000	\$37,978	\$ 750,000	\$ 920	\$(1,142,911)	\$2,584	\$ 148,571
Restatement to reflect 1981 Commodity Credit Corporation transfer (Note 8)	-	-	250,000	-	(250,000)	-	-
BALANCE AS RESTATED, September 30, 1987	500,000	37,978	1,000,000	920	(1,392,911)	2,584	148,571
Net loss for fiscal year	-	-	-	-	(626,373)	-	(626,373)
Transfer of invested capital for depreciation	-	-	-	(249)	249	-	-
Net capital additions	-	-	-	32	-	-	32
Net increase in unexpended appropriations	-	-	-	-	-	2,057	2,057
Transfers from Commodity Credit Corporation (Note 8)	-	-	900,000	-	-	-	900,000
BALANCE, September 30, 1988	500,000	37,978	1,900,000	703	(2,019,035)	4,641	424,287
Net loss for fiscal year	-	-	-	-	(548,039)	-	(548,039)
Transfer of invested capital for depreciation	-	-	-	(268)	268	-	-
Net capital additions	-	-	-	343	-	-	343
Net increase in unexpended appropriations	-	-	-	-	-	533	533
Transfers from Commodity Credit Corporation (Note 8)	-	-	400,000	-	-	-	400,000
BALANCE, September 30, 1989	\$500,000	\$37,978	\$2,300,000	\$ 778	\$(2,566,806)	\$5,174	\$ 277,124

The accompanying notes are an integral part of these statements.

Financial Statements

Statements of Loss

FOR FISCAL YEARS ENDED SEPTEMBER 30, 1989 AND 1988
(in thousands of dollars)

	<u>1989</u>	<u>1988</u> (Reclassified)
REVENUES:		
Premium (Notes 2 and 3)-		
Direct premium	\$ 90,588	\$ 61,963
Reinsurance premium	669,701	361,078
Underwriting gains to reinsured companies	(31,650)	-
	-----	-----
	728,639	423,041
Interest income	4,352	4,750
Other	5,182	2,681
	-----	-----
Total revenues	738,173	430,472
	-----	-----
EXPENSES:		
Insurance claims (Note 2)-		
Direct claims	156,946	151,263
Reinsurance claims	980,929	885,818
	-----	-----
	1,137,875	1,037,081
	-----	-----
Administrative expenses-		
Reinsurance administrative (Note 2)	265,890	154,663
Sales and service contractors' commissions (Note 2)	18,632	13,618
Claims adjustment contractors' costs (Note 2)	7,059	7,441
Provision for uncollectible accounts	1,258	1,629
Claims litigation	321	2,795
Interest expense	264	34
Salaries and other expenses (Notes 9, 10 and 11)	60,867	55,259
	-----	-----
	354,291	235,439
	-----	-----
Total expenses	1,492,166	1,272,520
	-----	-----
Loss from operations	(753,993)	(842,048)
	-----	-----
OTHER FINANCING SOURCES:		
Operating appropriations (Note 2)	205,954	215,675
	-----	-----
Net loss for fiscal year	(548,039)	(626,373)
	-----	-----
Credit arising from transfer of invested capital for depreciation on contributed assets (Note 2)	268	249
	-----	-----
Loss transferred to accumulated deficit	\$ (547,771)	\$ (626,124)
	-----	-----

The accompanying notes are an integral part of these statements.

Auditors' Report on Compliance With Laws and Regulations

ARTHUR ANDERSEN & Co.
KANSAS CITY, MISSOURI

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

To the Comptroller General of the United States and
the Board of Directors of the
Federal Crop Insurance Corporation:

We have audited the financial statements of Federal Crop Insurance Corporation as of and for the year ended September 30, 1989, and have issued our report thereon dated April 13, 1990. We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to Federal Crop Insurance Corporation is the responsibility of the Corporation's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Corporation's compliance with certain provisions of laws and regulations, as listed below. However, our objective was not to provide an opinion on overall compliance with such provisions.

- o Federal Crop Insurance Act, as amended (7 U.S.C. 1501-1520), and related regulations;
- o Anti-Deficiency Act (31 U.S.C. 1341-1519);
- o Debt Collection Act of 1982 (31 U.S.C. 3711-3719);
- o Prompt Payment Act (31 U.S.C. 3901-3906); and
- o Government Corporation Control Act of 1945 (31 U.S.C. 9105).

The results of our tests indicate that, with respect to the items tested, Federal Crop Insurance Corporation complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the Corporation had not complied, in all material respects, with those provisions.

This report is intended for the information of the board of directors, management and Congress. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Arthur Andersen & Co.

Kansas City, Missouri,
April 13, 1990

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2. CONTROL OVER ADMINISTRATIVE EXPENSES PROCESSED
BY THE U.S. DEPARTMENT OF AGRICULTURE
NATIONAL FINANCE CENTER (NFC)

Observations and Findings-

The Corporation has not established procedures to ensure all transactions sent to NFC for processing are accurately processed and recorded.

We suggest documents sent to NFC for processing be reconciled to administrative expense reports generated to ensure all transactions were processed and recorded.

Management's Response-

Agree. NFC has designed an on-line Fund Control which will have the capability of following an individual obligation through the payment process. The Corporation is currently working to provide data base access for all cost centers.

3. FINANCIAL REPORTING SYSTEMS
AND PROCEDURES

Observations and Findings-

The Corporation experiences long delays between the end of its fiscal year and the completion of the financial reporting process. The delays result from a number of problems, including: substantial manual manipulation required to finalize system-generated financial information; lack of timely and reliable financial information regarding premiums and losses; incomplete documentation of year-end closing and financial statement preparation procedures; and a shortage of personnel resources dedicated to the accounting and financial reporting function.

We suggest the Corporation investigate alternatives for improving its financial reporting systems and procedures to minimize or eliminate the delays caused by the problems noted above.

Management's Response-

Agree. The Corporation's management will examine its year-end closing process and identify improvements necessary to expedite preparation of the annual financial statements.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Auditors' Report on Internal Control Structure

ARTHUR ANDERSEN & Co.
KANSAS CITY, MISSOURI

REPORT ON INTERNAL CONTROL STRUCTURE

To the Comptroller General of the United States and
the Board of Directors of the
Federal Crop Insurance Corporation:

We have audited the financial statements of Federal Crop Insurance Corporation as of and for the year ended September 30, 1989, and have issued our report thereon dated April 13, 1990. We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Federal Crop Insurance Corporation, for the year ended September 30, 1989, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of Federal Crop Insurance Corporation is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that 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 internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- o Reinsured Company Premiums and Claims
- o Direct Insurance Premiums and Claims
- o Treasury
- o Purchasing
- o Payroll

Auditors' Opinion

ARTHUR ANDERSEN & CO.
KANSAS CITY, MISSOURI

To the Comptroller General of the United States and
the Board of Directors of
Federal Crop Insurance Corporation:

We have audited the accompanying statement of financial position of Federal Crop Insurance Corporation as of September 30, 1989, and the related statements of loss, cash flows and equity for the fiscal year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Federal Crop Insurance Corporation as of September 30, 1988, were audited by other auditors whose report dated September 15, 1989, emphasized the Corporation's continued losses from operations and the need for additional government funding to sustain operations.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Federal Crop Insurance Corporation as of September 30, 1989, and the results of its operations, cash flows and changes in equity for the fiscal year then ended in conformity with generally accepted accounting principles.

As discussed in Note 12, the Federal Crop Insurance Corporation has experienced recurring losses from operations and has an accumulated deficit of approximately \$2.6 billion at September 30, 1989. Without significant changes in insurance program operations, the Corporation will likely continue to suffer significant losses and require additional government funding. In addition, the Administration released its 1991 budget proposal on January 30, 1990, which, among other things, would terminate funding for the Federal Crop Insurance program effective with the 1991 crop year. Funding for 1991 under

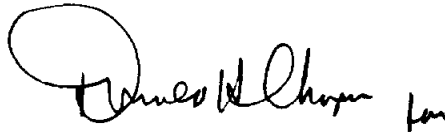
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Abbreviations

NFC	National Finance Center
USDA	United States Department of Agriculture

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.

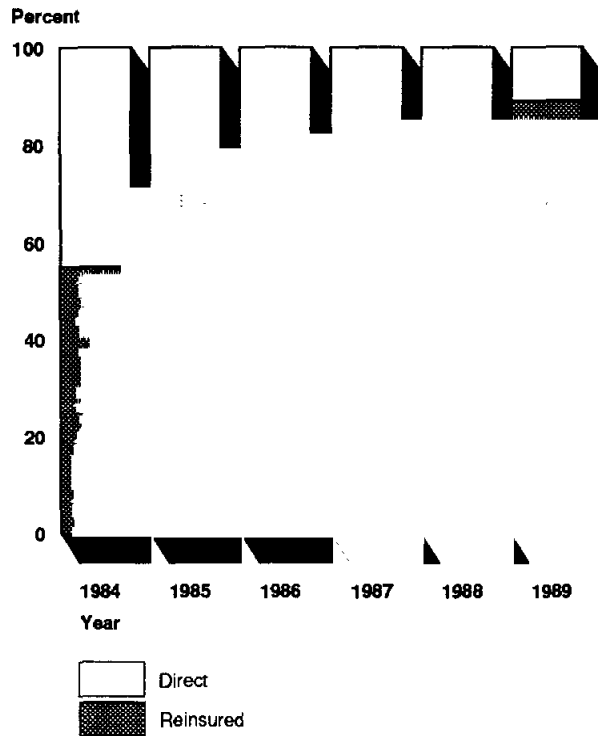
A handwritten signature in black ink, appearing to read "Charles A. Bowsher". The signature is written in a cursive style with a large initial "C".

Charles A. Bowsher
Comptroller General
of the United States

Reinsurance Program Has Resulted in Higher Costs

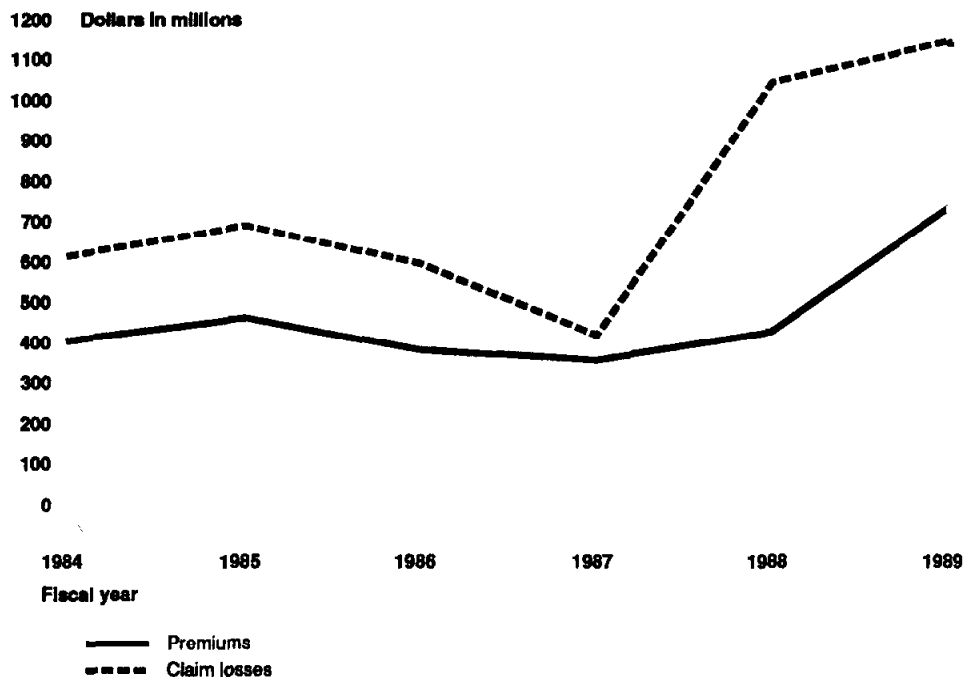
The 1980 act mandated that the Corporation offer a program of reinsurance to the private sector. Prior to the act, crop insurance was sold and serviced primarily by Corporation employees. Since passage of the act, however, the Corporation has steadily increased the amount of insurance written by private companies, which it reinsures. As shown in figure 3, reinsured business has increased from 55 percent in 1984 to 88 percent in 1989.

Figure 3: Direct and Reinsured Coverage



Administrative costs for the reinsurance program have been higher than the administrative costs for the direct insurance program over the 6 years ended September 30, 1989. These administrative costs do not include the cost of Corporation support salaries and other costs allocable to both the direct and reinsurance service delivery systems. Expressed as a ratio of costs to premiums, direct insurance administrative costs averaged 24 percent during the period 1984 through 1989, while reinsurance administrative costs for those same years averaged 37 percent. Standard reinsurance agreements provide for payment of

Figure 2: Premiums and Claim Losses for Fiscal Years 1984 Through 1989



Premiums have not kept pace with claims due to a reluctance by the Corporation to raise rates and thereby risk reducing program participation.

Expansion Has Resulted in Increased Losses

Although crop insurance has been available to producers since 1938, growth in the program was slow because of restrictions on operations in high-risk areas as well as budget limitations. Prior to 1981, the crop insurance program covered selected crops in certain counties and producers paid the full cost of the premium. Claims have exceeded premiums every year since the 1980 act expanded the insurance program nationwide, as discussed previously. However, 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 losses, as authorized by the act. The Corporation is concerned that higher premium rates would reduce producer participation in the crop insurance program.

A cornerstone of a financially sound insurance program is sufficient participation to spread losses. An actuarial analysis of the 1980 act's provisions indicated that participation by producers would reach

how Corporation expenses were processed, (2) comparing the tapes to detailed transaction registers to verify transactions processed, and (3) tracing a sample of transactions from registers to source documentation. To correct this weakness, the National Finance Center has designed an on-line fund control system for obligations and is working to provide this data base to the individual Corporation cost centers that input the data.

Financial Reporting Systems and Procedures

Although not a material weakness that could result in additional losses, the Corporation's ability to prepare and compile financial information, including financial statements, was considered to be a reportable condition. Arthur Andersen found a number of problems that contributed to long delays in the completion of accounting functions, particularly at year-end. These included the inability of financial systems to generate needed data, incomplete documentation of closing procedures, and a shortage of financial personnel.

The Corporation is examining its year-end closing procedures to identify areas for improvement in order to expedite preparation of its future annual financial statements.

Compliance With Laws and Regulations

Arthur Andersen's report on compliance with laws and regulations, with which we concur, disclosed nothing to indicate that the Federal Crop Insurance Corporation had not complied with such applicable laws and regulations that could have a material effect on the financial statements.

The Corporation's Financial Condition Is Bleak

This section of our report provides additional information on the Federal Crop Insurance Corporation's financial condition. The Corporation's accumulated deficit is growing, and its premium revenues are insufficient to cover insurance claims and expenses. Contributing factors to the Corporation's large losses include the expansion of the program as required by the Federal Crop Insurance Act of 1980; low producer participation; adverse weather conditions, particularly the 1988 drought; and competition with the disaster payments program. The shift from direct insurance to third-party private reinsurance has also resulted in more claim overpayments and higher administrative costs.

Crop insurance covers unavoidable production losses due to any adverse weather conditions including drought, excessive rain, hail, wind, hurricanes, tornadoes, and lightning. It also covers losses due to insects, plant disease, floods, fire, and earthquakes. Crop insurance does not cover losses due to neglect, poor farming practices, or theft. Producers can insure for 50, 65, or 75 percent of expected crop yield. The Corporation, through appropriated funds, subsidizes the premium up to a maximum of 30 percent for coverage at 65 percent of expected crop yield.

The 1980 act expanded the program in anticipation of phasing out the Disaster Payment Program which was authorized by the Agriculture Act of 1949. The 1980 act also encouraged the sale of crop insurance through privately licensed agents and brokers. Private insurers now write 88 percent of the crop insurance, which is reinsured by the Corporation against extraordinary operational and actuarial losses. Reinsured companies sell and service crop insurance policies under their own names and are responsible for making claim adjustments.

The remaining 12 percent of the crop insurance is written by the Corporation through private agents for crops and geographic areas not covered by private insurers, or in cases where farmers prefer to buy insurance through private agents who also handle their other insurance needs. Also, some farmers prefer to buy their insurance directly from the Corporation instead of through reinsured companies. The Corporation is directly responsible for all losses and for adjusting claims on the policies it writes.

Opinion on Financial Statements

We are required to conduct an audit of the Corporation at least once every 3 years under the provisions of 31 U.S.C. 9105. To fulfill our responsibility, we contracted with the independent certified public accounting firm of Arthur Andersen to conduct a financial audit of the Corporation for the year ended September 30, 1989. We determined the scope of the audit work, monitored its progress at key points, reviewed the working papers of the certified public accountants, and performed other procedures as we deemed necessary. The 1989 audit was conducted in accordance with generally accepted government auditing standards. The prior financial audit of the Corporation for the year ended September 30, 1988, was conducted by us (GAO/AFMD-90-43, April 18, 1990).

In our opinion, and consistent with the opinion of Arthur Andersen, the Federal Crop Insurance Corporation's financial statements present

