



U.S. Department of Agriculture  
Office of Inspector General  
Financial and IT Operations  
Audit Report

FEDERAL CROP INSURANCE  
CORPORATION/RISK MANAGEMENT  
AGENCY'S FINANCIAL STATEMENTS  
for FISCAL YEARS 2002 and 2001



**Audit Report No.  
05401-11-FM  
January 2003**



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: **JAN 09 2003**

REPLY TO

ATTN OF: 05401-11-FM

SUBJECT: U.S. Department of Agriculture  
Federal Crop Insurance Corporation/Risk Management Agency's  
Financial Statements for Fiscal Years 2002 and 2001

TO: Ross Davidson  
Administrator  
Risk Management Agency

This report presents the auditors' opinion on the Federal Crop Insurance Corporation (FCIC)/Risk Management Agency (RMA) principal financial statements for the fiscal years ending September 30, 2002 and 2001. Reports on FCIC/RMA's internal control structure and its compliance with laws and regulations are also provided.

KPMG Peat Marwick LLP, an independent certified public accounting firm, conducted the audit. We monitored the progress of the audit at all key points, reviewed the workpapers, and performed other procedures, as we deemed necessary. We determined the audit was conducted in accordance with generally accepted auditing standards, Government Auditing Standards (issued by the Comptroller General of the United States), and the Office of Management and Budget's Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

It is the opinion of KPMG Peat Marwick LLP, that the financial statements present fairly, in all material respects, FCIC/RMA's financial position as of September 30, 2002 and 2001, and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles. We concur with that opinion. The KPMG Peat Marwick LLP report on FCIC/RMA's internal control structure over financial reporting identified three reportable conditions. Specifically, KPMG identified reportable conditions in FCIC/RMA's (1) Administrative and Operating Fund Balance Reconciliation (Material Weakness); (2) Monitoring of Reinsured Organizations (Reportable Condition); and (3) Financial Reporting Process (Reportable Condition).

Although KPMG Peat Marwick LLP believes the Monitoring of Reinsured Organizations is a reportable condition for financial statement purposes, we believe the uncorrected deficiencies in this area constitute a material weakness from the operational perspective, in that they do not allow for reasonable assurance that improper payments are precluded or detected in a timely manner.

The results of KPMG's tests of compliance with laws and regulations disclosed instances of noncompliance with the laws and regulations identified below:

- The Privacy Act of 1974;
- The Federal Financial Management Improvement Act of 1996.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes to address the reports' recommendations. Please note the regulation requires a management decision to be reached on all findings and recommendation within a maximum of 6 months from report issuance.

A handwritten signature in black ink that reads "Richard D. Long". The signature is written in a cursive style with a large, sweeping initial "R".

RICHARD D. LONG  
Assistant Inspector General  
for Audit



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Suite 1600  
Kansas City, MO 64106

## Independent Auditors' Report on Consolidated Financial Statements

The Inspector General  
U.S. Department of Agriculture and the  
Board of Directors of the Federal  
Crop Insurance Corporation:

We have audited the accompanying consolidated balance sheets of the Federal Crop Insurance Corporation/Risk Management Agency (FCIC/RMA) as of September 30, 2002 and 2001, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the years then ended. The consolidated financial statements are the responsibility of the FCIC/RMA's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the FCIC/RMA as of September 30, 2002 and 2001, and its net costs, changes in net position, reconciliation of net costs to budgetary obligations, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 14 to the consolidated financial statements, the FCIC/RMA has changed its accounting policy relating to accounting for appropriations and the timing of recording budgetary obligations.

The information in the Management's Discussion and Analysis, Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.



In accordance with *Government Auditing Standards*, we have also issued reports, dated December 15, 2002, on our consideration of the FCIC/RMA's internal control over financial reporting and its compliance with certain provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of the FCIC/RMA's management, the Department of Agriculture's Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 15, 2002



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Suite 1600  
Kansas City, MO 64106

## Independent Auditors' Report on Internal Control Over Financial Reporting

The Inspector General  
U. S. Department of Agriculture and the  
Board of Directors of the Federal Crop Insurance  
Corporation:

We have audited the consolidated balance sheet of the Federal Crop Insurance Corporation/Risk Management Agency (FCIC/RMA) as of September 30, 2002, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated December 15, 2002. Our report refers to the FCIC/RMA's change in accounting principle relating to accounting for appropriations. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our fiscal year 2002 audit, we considered the FCIC/RMA's internal control over financial reporting by obtaining an understanding of the FCIC/RMA's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls as defined by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The objective of our audit was not to provide assurance on the FCIC/RMA's internal control. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect FCIC/RMA's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated 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. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

We noted certain matters described in Exhibit I and Exhibit II involving the internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable condition in Exhibit I is a material weakness. This material weakness was not previously identified by management and consequently was not reported in the FCIC/RMA's FMFIA report.



### **Additional Required Procedures**

As required by OMB Bulletin No. 01-02, we considered the FCIC/RMA's internal control over required supplementary stewardship information by obtaining an understanding of the FCIC/RMA's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over required supplementary stewardship information, and, accordingly, we do not provide an opinion on such controls.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section of the FCIC/RMA consolidated financial statements, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

\* \* \* \* \*

We also noted other matters involving internal control and its operation that we have reported to the management of the FCIC/RMA in a separate letter dated December 15, 2002.

This report is intended solely for the information and use of the FCIC/RMA's management, the Department of Agriculture's Office of the Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

December 15, 2002

**Federal Crop Insurance Corporation/Risk Management Agency  
Material Weakness in Internal Control**

**Finding No. 1—Administrative and Operating Fund Balance Reconciliation**

The FCIC/RMA has entered into a Memorandum of Understanding (MOU) with the U.S. Department of Agriculture National Finance Center (NFC) that identifies specific services that the NFC will perform for FCIC/RMA. In accordance with the MOU, the NFC is responsible for performing fund balance reconciliations of the SF-6653 reports on a monthly basis, and identifying adjusting entries, which are recorded after discussion and review by designated FCIC/RMA personnel. In addition, the NFC is required to communicate with the U.S. Treasury Financial Management Service (FMS) and the FCIC/RMA about outstanding items that cannot be reconciled.

The NFC performs the monthly reconciliations for FCIC/RMA and other USDA agencies utilizing methodologies that reconcile the monthly activity rather than reconcile the month-end closing balance per the FMS report to the FCIC/RMA's general ledger. The reconciliation does not clearly identify differences due to timing versus those due to error. Furthermore, we determined that the FCIC/RMA personnel responsible for reviewing the reconciliations did not perform additional research and take corrective action to understand, identify, or record necessary adjustments, timely.

These control procedures do not meet the requirements of OMB Circular A-123, *Management Accountability and Control* or of SFFAS No. 1, paragraph 39 which states: "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared.)"

The FCIC/RMA cannot reasonably ensure that the Administrative and Operating fund balance is correct, because reconciling items are not identified and cleared, timely. While the NFC has classified the reconciling differences into various account categories, detailed explanations were neither provided nor did the FCIC/RMA take corrective actions. The reconciling items are carried forward each month, as well as from prior years. As a result, the balance per the FMS report exceeds the FCIC/RMA's adjusted balance by approximately \$1.1 million (net). These differences were included within three different treasury symbols (12F3875, -\$2.9 million; 12F3885, \$1.0 million; and 12012707, \$0.8 million). We reviewed over 200 transactions totaling approximately \$10.7 million (absolute value) that had not been adjusted for in the FCIC/RMA's consolidated financial statements. These differences were in addition to a net difference of \$2.4 million for which the FCIC/RMA made a blanket adjustment for in the consolidated financial statements.

**Recommendation #1:** We recommend that the FCIC/RMA work with the NFC to redesign the reconciliation procedures performed, to provide an effective reconciliation of balances. Further, we recommend that FCIC/RMA personnel begin to perform effective reviews of the reconciliations performed by NFC, including completing appropriate investigations of reconciling items and making necessary corrections.



**Federal Crop Insurance Corporation/Risk Management Agency  
Reportable Conditions in Internal Control**

**Finding No. 2—Monitoring of Reinsured Organizations**

The Office of Risk Compliance (ORC), Fiscal Operations and Systems Division (FOSD), and the Reinsurance Services Division (RSD), representing different areas of the FCIC/RMA, are responsible for performing separate control procedures overseeing the Reinsured Organizations. In addition, the Reinsured Organizations (RO's) are responsible under the Standard Reinsurance Agreement to self regulate their operations.

The Office of the Inspector General (OIG) issued a March 15, 2002 audit report entitled, *Monitoring of FCIC/RMA's Implementation of Manual 14 Reviews/Quality Control Review System*. The OIG position is that the FCIC/RMA's quality control program does not meet the standards for internal control in the Federal government. The OIG believes the quality control system employed by the FCIC/RMA does not provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, or misappropriation. We reported this matter as a material weakness in internal control in our fiscal year 2001 audit of FCIC/RMA.

The OIG recommended that the FCIC/RMA revise its FMFIA report dated October 1, 2001, to identify the absence of a reliable quality control review system as a material weakness. The FCIC/RMA's response to the audit stated their belief that this did not constitute a material weakness.

In response, the FCIC/RMA management issued a letter highlighting controls that they believed were in place to promote a) prevention and/or detection of waste, fraud, or mismanagement of programs and resources at the reinsured organizations or producer level, or b) complete, accurate, valid and timely data from reinsured organizations. Additionally, the FCIC/RMA management provided to us highlights of the control objectives, a description of each control, control procedures performed, documentation of the controls, and which specific division was responsible for performing the control. Management also identified other controls that they believe were effective in meeting the control objectives.

We performed tests over the procedures identified by the FCIC/RMA management as well as controls identified during the audit to determine if they were designed properly and operating effectively to achieve the control objectives. As part of this process, we considered whether or not: (1) the FCIC/RMA had procedures in place to assess the relevant risks to achieve the control objectives; (2) control procedures were designed appropriately and operating effectively during the majority of the period under audit; (3) controls were successful at identifying and communicating legitimate errors to appropriate members of management; (4) management was taking action to research, understand the errors identified by the control procedures; (5) procedures for correcting and resolving issues exist; and (6) there was a monitoring system in place to routinely evaluate and assess the quality of internal control performance, over time.

The controls identified by the FCIC/RMA management and our observations and recommendations related thereto are presented in Exhibit III. Exhibit III identifies those instances where we believe there is an elevated risk of failure to (1) prevent and/or detect waste, fraud, or mismanagement of programs and resources at the reinsured organizations or producer level, or (2) obtain complete, accurate, valid and timely data from reinsured organizations due to ineffective control design or lack of operating effectiveness. We concluded that these conditions represent a reportable condition. As a result, we expanded our substantive audit procedures to compensate for this deficiency.

**Recommendation #2:** We recommend that the FCIC/RMA identify all known and perceived risks related to (1) the possibility of waste, fraud, or mismanagement of programs and resources at the reinsured organizations or producer levels, or (2) the reinsured organizations' ability to provide complete, accurate, valid and timely data. Current control processes should be aligned against these

**Federal Crop Insurance Corporation/Risk Management Agency  
Reportable Conditions in Internal Control**

risks to identify gaps, and current control processes should be analyzed and refined to ensure that the process meets the criteria described above.

**Finding No. 3—Financial Reporting Process**

OMB Circular 01-09, *Form and Content of Agency Financial Statements*, provides guidance for preparing agency financial statements and contains financial reporting requirements that advance Federal agencies toward more timely, useful, and reliable financial information to support agency management. It states that, “Preparation of the annual financial statement is the responsibility of agency management. In carrying out that responsibility, each agency CFO should prepare a policy bulletin or guidance memorandum that guides agency fiscal and management personnel in the preparation of the annual financial statement.”

This guidance also states that, “Basic statements prepared in accordance with this Bulletin should present summary or detailed information necessary to make the statements most useful to users...Where substantial detail is necessary to properly convey the information, the body of the statement should contain summary information and the detail should be reported in notes to the statements.”

The FCIC/RMA is responsible for the proper presentation of its consolidated financial statements. As such, the closing process should encompass all accounting entries necessary to present accurate financial information. Also, an adequate review process should be in place to assess the financial statements prepared.

Our review of the financial statements, and the procedures by which they were prepared, indicated that the FCIC/RMA does not include an effective review of the consolidated financial statements by someone other than the preparer. As a result, the FCIC/RMA relies heavily on the audit process to identify required adjusting entries and review the required consolidated financial statements and footnote disclosures to ensure accuracy, completeness, and proper presentation and disclosure. As a result, the FCIC/RMA does not have effective controls over its financial reporting process.

**Recommendation #3:** We recommend that the FCIC/RMA develop a checklist of year-end procedures that identifies all information that will be required for completion of the consolidated financial statements, the responsible party, and the party to review the accuracy of that information. Further, the FCIC/RMA should identify appropriate parties within the organization who have the necessary knowledge of financial accounting requirements to review the consolidated financial statements prior to their being presented for audit.

**Federal Crop Insurance Corporation/Risk Management Agency  
Controls Over Monitoring Reinsured Organizations**

The comments and recommendations included in this exhibit should not be construed as a conclusion on any individual control. These comments and recommendations were developed in our consideration of the existence of the reportable condition identified in Exhibit II.

<b>FISCAL OPERATIONS BRANCH</b>			
	<b>Control</b>	<b>Observation(s)</b>	<b>Recommendation(s)</b>
1	Performs periodic financial reviews of the Reinsured Organizations (RO)	<ul style="list-style-type: none"> <li>Resolution of findings not documented</li> <li>Scope of 3 year rotation of all RO's not expected to be completed until 2003</li> <li>Procedures limited to verification of reported data from RO's, premium collections, and escrow reconciliations</li> <li>Insufficient resources to execute</li> </ul>	<ul style="list-style-type: none"> <li>Must obtain/monitor documented evidence of the resolution for each issue</li> <li>Ensure all 10 remaining reviews are performed</li> <li>Expand review procedures to encompass the RO's operations as a whole</li> <li>Review staff levels to involve more employees in the review process</li> </ul>
2	Quarterly reconciliation of premium receivables, premiums and losses between the Accounting Reporting System (ARS) and the general ledger	<ul style="list-style-type: none"> <li>Reconciliation is necessary due to significant manual effort</li> </ul>	<ul style="list-style-type: none"> <li>Work to implement an automated system complete with edit checks to facilitate the process</li> </ul>
3	Monthly reconciliation and review of RO operations reports	<ul style="list-style-type: none"> <li>No exceptions noted</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
4	Verification and vouching of loss payments to the Treasury	<ul style="list-style-type: none"> <li>Several user ID and pass codes utilized by personnel for this procedure belong to former employees</li> </ul>	<ul style="list-style-type: none"> <li>Update all user ID, pass codes, and authorization levels immediately</li> </ul>
5	Monthly review of RO escrow bank account reconciliations	<ul style="list-style-type: none"> <li>Escrow account reconciliations performed by RO's not received on timely basis</li> <li>Reconciling items not identified and resolved on a timely basis</li> <li>Inactive RO accounts remain on GL</li> <li>Identified reconciling items not being recorded in the general ledger in a timely manner</li> <li>Reconciliations performed on a rollforward basis</li> <li>Compliance issue on stale checks related to Comptroller General B-270624</li> </ul>	<ul style="list-style-type: none"> <li>Ensure all reconciliations are received from the RO each month</li> <li>Identify and clear reconciling items within 60 days of the reconciliation date</li> <li>Close all inactive accounts</li> <li>Ensure that monthly activity is recorded in the GL within 30 days of the reconciliation date</li> <li>Prepare a balance-to-balance reconciliation each month</li> <li>Require that all RO's void checks over six years old to be in compliance with opinion B-270624</li> </ul>
6	Contacting the RO's to verify actual activity vs. estimated activity and the amount of the backlog at year-end	<ul style="list-style-type: none"> <li>No exceptions noted</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>

**Federal Crop Insurance Corporation/Risk Management Agency  
Controls Over Monitoring Reinsured Organizations, Continued**

<b>REINSURANCE SERVICES DIVISION</b>			
	<b>Control</b>	<b>Observation(s)</b>	<b>Recommendation(s)</b>
1	Performs a review of the RO plan of operations	<ul style="list-style-type: none"> <li>• Knowledge of reinsurance/insurance industry solid however statutory US accounting technical expertise limited</li> <li>• Standard Reinsurance Agreement does not mandate submission of quarterly RO MD&amp;A, financial statements and footnotes</li> </ul>	<ul style="list-style-type: none"> <li>• Provide additional training to improve knowledge of statutory US accounting</li> <li>• Update the SRA to require the RO's to provide quarterly MD&amp;A, financial statements and footnotes</li> </ul>
2	Prepares a financial analysis of all RO's	<ul style="list-style-type: none"> <li>• Analysis procedures performed annually</li> <li>• Hindsight financial statement trend and ratio analysis not performed</li> </ul>	<ul style="list-style-type: none"> <li>• Perform financial statement analysis on a quarterly basis</li> <li>• Perform a hindsight financial statement trend and ratio analysis on a quarterly basis</li> </ul>
3	Prepares a "Most Possible Underwriting Loss" analysis	<ul style="list-style-type: none"> <li>• Analysis procedure performed annually</li> <li>• Financial reinsurance programs not evaluated in calculating surplus adequacy</li> <li>• Most adverse loss ratio assumption (500%) results in minimal effectiveness as dynamic analysis tool</li> </ul>	<ul style="list-style-type: none"> <li>• Perform analysis on a quarterly basis</li> <li>• Include financial reinsurance programs in calculating surplus adequacy</li> <li>• Prepare loss ratio analysis based on various loss scenarios to improve effectiveness</li> </ul>
4	Compares monthly premium and loss estimates to actual losses	<ul style="list-style-type: none"> <li>• Focus on technical underwriting results does not address overall financial stability of company, but relies on ratings agencies to highlight</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>
5	Monitors credit risk of RO's	<ul style="list-style-type: none"> <li>• No exceptions noted</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>
6	Resolves policy issues (i.e., acreage, coverage, billing, damage/loss, etc.) with all RO's	<ul style="list-style-type: none"> <li>• Process relies on RO's to highlight issues relying inherently on the adequacy of the RO internal controls given RO assessment of materiality</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>

**Federal Crop Insurance Corporation/Risk Management Agency  
Controls Over Monitoring Reinsured Organizations, Continued**

<b>REGIONAL COMPLIANCE OFFICES</b>			
1	Investigates all issues reported by 2007 FSA reports, the OIG, the FCIC/RMA data mining results and the crop disaster program	<ul style="list-style-type: none"> <li>• Clearance rate of issues is 10% of reported cases and 25% of policies as of 9/30/02 for Central Region</li> <li>• Prioritization of issues for resolution relies heavily on manual process and knowledge of key personnel</li> <li>• Data mining adding data for use by RCO not necessarily information</li> <li>• Data mining pre-formulated reports not broad enough in scope nor consistently used by RCO's to identify and resolve significant issues in a timely manner</li> <li>• RCO use of data mining for analysis not consistent across RCO's and/or routine (i.e. an ad hoc basis)</li> <li>• No cross link of policies, insureds, etc identified by data mining to those arising from other sources (see above)</li> <li>• Automated benchmarking by significant common issues not currently a key output of data mining efforts</li> <li>• Resource constraints given volume of activity as evidenced by clearance rate</li> </ul>	<ul style="list-style-type: none"> <li>• Implement procedures to improve clearance rate to at least 80% of all cases reported and to monitor 100% of all policies</li> <li>• Implement a standard process to assist in automatically prioritize issues</li> <li>• Revise the information provided by the reports to provide more useful and comprehensive information for more consistent application of output by RCO's</li> <li>• Utilize reporting procedures that require RCO's to provide monthly or quarterly status reports to chief management</li> <li>• Put into operation an automated report to monitor known benchmarks common among all RCO's</li> <li>• Find more resources to assist in process, reassign tasks or streamline process to maximize employees' efforts</li> </ul>
2	Investigates exceptions identified through the FSA and the FCIC/RMA data reconciliation process	<ul style="list-style-type: none"> <li>• Did not receive sufficient evidence to evaluate</li> </ul>	<ul style="list-style-type: none"> <li>• Did not receive sufficient evidence to evaluate</li> </ul>
3	Performs a quality control review of all Manual 14 reviews prepared by RO's	<ul style="list-style-type: none"> <li>• QC guidelines do not provide for performance-based reviews</li> <li>• RO responses to QC review were inadequate to prevent recurrence of issues noted</li> <li>• QC review limited by resource constraints</li> <li>• QC review results applicable for FY 2002 not available</li> <li>• Samples were not statistically selected and results cannot be projected</li> </ul>	<ul style="list-style-type: none"> <li>• Revise QC guidelines to produce more reliable and consistent results</li> <li>• Require RO's to implement procedures to prevent future instances of noncompliance and/or provide evidence that the issues have been actively resolved</li> <li>• Perform the QC review on a more timely basis to ensure valid results are available at the end of the fiscal year</li> <li>• Use statistical sampling methods</li> </ul>

**Federal Crop Insurance Corporation/Risk Management Agency  
Controls Over Monitoring Reinsured Organizations, Continued**

<b>FARM SERVICE AGENCY REGIONAL OFFICES</b>			
1	Investigates issues identified internally or by the RCO's and RO's	<ul style="list-style-type: none"> <li>Manual and training exist and have been performed, but evaluation of adequacy of procedures performed by FSA in accordance with prescribed procedures not yet undertaken</li> </ul>	<ul style="list-style-type: none"> <li>Evaluate adequacy of FSA procedures in place and employee knowledge of prescribed procedures</li> </ul>
<b>REINSURED ORGANIZATIONS</b>			
1	Prepares all Manual 14 reviews	<ul style="list-style-type: none"> <li>Significant Manual 14 weaknesses have been identified, but not resolved</li> <li>Approved insurance providers have not reported the required number of reviews as outlined in Manual 14</li> <li>Liquidated damages cannot be accurately determined</li> <li>Annual summaries provided by RO's do not provide meaningful or comparable review results from year-to-year</li> <li>Manual 14 does not provide clear performance standards for verifying data or clearly define an error or acceptable error rate</li> <li>APH Tolerance review procedures may not protect program from abuse</li> </ul>	<ul style="list-style-type: none"> <li>The RMA/FCIC needs to revise Manual 14 to address weaknesses noted, clarify definitions and instructions and establish performance standards</li> <li>Employ performance incentives or increase liquidated damages to encourage compliance</li> <li>Clearly define liquidated damages so that they may be more accurately calculated and agreed upon</li> <li>Implement more comprehensive requirements for annual summaries</li> <li>The RMA/FCIC needs to revise Manual 14 to address weaknesses noted, clarify definitions and instructions and establish performance standards</li> <li>Revise APH Tolerance review procedures to ensure detection of abuse</li> </ul>
2	Resolves all issues referred by the RCO's	<ul style="list-style-type: none"> <li>Did not receive sufficient evidence to evaluate</li> </ul>	<ul style="list-style-type: none"> <li>Did not receive sufficient evidence to evaluate</li> </ul>
3	Reports data to the FCIC/RMA monthly through the Data Acceptance System (DAS) and confirm the monthly operations reports created by ARS	<ul style="list-style-type: none"> <li>No exceptions noted</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>

**Federal Crop Insurance Corporation/Risk Management Agency  
Controls Over Monitoring Reinsured Organizations, Continued**

<b>INFORMATION TECHNOLOGY CONTROLS</b>			
1	Pre-edit checks on data prior to submission into DAS/ARS	• No exceptions noted	• None
2	Detailed edit and integrity check over data submitted by the RO server	• No exceptions noted	• None
3	Semi-annual reconciliation of RO server data to DAS/ARS data receipts	• No exceptions noted	• None
4	Authorization check on data that is subsequently modified in DAS/ARS	• No exceptions noted	• None
5	Accuracy tests for duplicate RO submissions and policies	• No exceptions noted	• None
6	Job scheduling to ensure timely data submission	• No exceptions noted	• None
7	Regularly scheduled backup procedures	• No exceptions noted	• None
8	Recalculations for accuracy checks on amounts reports	• No exceptions noted	• None
9	Monthly RO operations report reconciliation to DAS/ARS to verify accuracy of information	• No exceptions noted	• None
10	RO to DAS and DAS to ARS error logs are tracked through a resolution process	• No exceptions noted	• None
11	Log and document reruns and operator interventions	• No exceptions noted	• None
12	Monitor and resolve RO to DAS/ARS reject reports	• Procedure not performed	• Utilize an error suspense file to ensure that all rejects are corrected and resubmitted



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## Independent Auditors' Report on Compliance with Laws and Regulations

The Inspector General  
U. S. Department of Agriculture and the  
Board of Directors of the Federal  
Crop Insurance Corporation:

We have audited the consolidated balance sheet of the Federal Crop Insurance Corporation/Risk Management Agency (FCIC/RMA) as of September 30, 2002, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated December 15, 2002. Our report refers to the FCIC/RMA's change in accounting principle relating to accounting for appropriations. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the FCIC/RMA is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the FCIC/RMA's consolidated financial statements are free of material misstatement, we performed tests of the FCIC/RMA's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the FCIC/RMA. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.

The results of our tests of compliance with certain provisions of laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described below.

The FCIC/RMA has not published in the Federal Register its system of records as required by the Privacy Act of 1974. At September 30, 2002, all seven systems of records notices had been drafted and were in the internal review process leading to publication. Subsequent to year-end, three systems of record notices were published.

**Recommendation #4:** We recommend the FCIC/RMA publish the remaining system of record notices.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the second paragraph of this report, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.





Under FFMIA, we are required to report whether the FCIC/RMA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed instances, described below, where the FCIC/RMA financial management systems did not substantially comply with Federal financial management systems requirements and the United States Government Standard General Ledger at the transaction level.

The FFMIA does not itself establish financial system requirements. However, it does establish a statutory requirement for agency-heads to assess, on an annual basis, whether their financial management systems comply with the three requirements of the FFMIA. If they do not, agencies are required to develop remediation plans and file them with OMB. In addition, OMB's Revised Implementation Guidance for the FFMIA, dated January 4, 2001 recognizes OMB Circular A-127, *Financial Management Systems*, as a reference document for government-wide financial management systems. Reviews of financial management systems performed in accordance with OMB Circular A-127 provide the basis for agency management's annual assurance statements for Section 4 of the *Federal Managers' Financial Integrity Act (FMFIA)* and the FFMIA.

OMB Circular A-127, Section 7, paragraph G provides that agency financial management systems shall conform to existing applicable functional requirements as defined in the Federal financial management systems requirements issued by the Joint Financial Management Improvement Program (JFMIP). Section 9, paragraph A3 of OMB Circular A-127 provides that each agency shall ensure appropriate reviews are conducted of its financial management systems and these reviews must determine whether agency financial management systems comply with the Federal financial management systems requirements issued by the JFMIP.

OMB Circular A-123, Section III, *Assessing and Improving Management Controls*, provides that agency managers should continuously monitor and improve the effectiveness of management controls associated with their programs. OMB Circular A-123 also provides that this continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on management controls, as required by the FMFIA.

The FCIC/RMA could not provide evidence to support compliance of the FCIC/RMA financial management systems with the Federal financial management systems requirements issued by the JFMIP. This occurred because the FCIC/RMA had not implemented a continuous monitoring effort to ensure that its financial management systems complied with the Federal financial management systems requirements in support of its annual assurance statement made under Section 4 of the FMFIA. As a result, FCIC/RMA cannot provide reasonable assurance that its financial management systems comply with Federal financial management systems requirements as required by the FFMIA.

In addition to the lack of systems reviews, we noted other instances during our audit where FCIC/RMA financial management systems do not comply with Federal financial management systems requirements. For example, we determined that FCIC/RMA's Insurance Fund budgetary accounts are not included in the general ledger system. FCIC/RMA accounted for over \$2.8 billion in budgetary authority using these accounts. These accounts are maintained in a separate data file and are periodically updated using manual procedures that are in addition to the procedures used to update FCIC/RMA's proprietary accounts in the general ledger system. OMB Circular A-127 and JFMIP financial systems requirements require that the system update all applicable general ledger account balances (i.e., budgetary, proprietary and memorandum accounts) based on a single input transaction.

We also noted that FCIC/RMA recently contracted for an emerging information technology architecture study. In its Phase II report entitled "Current Business Practices Assessment

Report,” dated November 15, 2001, the contractor noted the lack of automated integration between the general ledger and the other accounting databases. According to the contractor’s report, this lack of integration resulted in largely a manual process of examining different databases using intermediate spreadsheets and other means of inspections/comparisons to generate manual journal vouchers. OMB Circular A-127 and JFMIP financial systems requirements require that agencies establish and maintain a single, integrated financial management system. OMB Circular A-127 defines a “single, integrated financial management system” as a unified set of financial systems and the financial portions of mixed systems. The Circular further defines that “unified” means that the systems are planned for and managed together, operated in an integrated fashion, and linked together electronically (emphasis added) in an efficient and effective manner.

We also noted that the FCIC/RMA has not completed a financial management systems five-year plan, as required by OMB Circular A-127.

**Recommendation #5:** We recommend the FCIC/RMA develop and implement an independent comprehensive and continuous monitoring/testing effort to ensure that all FCIC/RMA financial management systems comply with Federal financial management systems requirements. This review should result in maintenance of adequate documentation to support this monitoring/testing effort and that this effort, provide the basis for the RMA Administrator’s annual assurance statement as it relates to Section 4 of the FMFIA.

Further, this monitoring/testing effort should include procedures to communicate the results of FCIC/RMA’s monitoring/testing efforts of its financial management systems to appropriate management personnel responsible for determining substantial compliance with the FFMA. The FCIC/RMA should ensure that these procedures provide for development of a FFMA remediation plan when a determination is made that FCIC/RMA’s financial management systems are not in substantial compliance with the FFMA.

**Recommendation #6:** We recommend that FCIC/RMA develop a process to integrate its Program Fund budgetary accounts into the general ledger system, at the transaction level, by September 30, 2003.

**Recommendation #7:** We recommend the FCIC/RMA develop the five-year financial statement systems plan, as required.

The results of the audit disclosed no instances in which the FCIC/RMA’s financial management systems did not substantially comply with Federal accounting standards.

\* \* \* \* \*

We also noted other matters involving compliance with laws and regulations that, under *Government Auditing Standards* and OMB Bulletin No. 01-02, were not required to be included in this report, that we have reported to the management of the FCIC/RMA in a separate letter dated December 15, 2002.

This report is intended solely for the information and use of the FCIC/RMA’s management, the Department of Agriculture’s Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 15, 2002

FEDERAL CROP INSURANCE CORPORATION  
RISK MANAGEMENT AGENCY  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2002 and 2001

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **Mission and Organizational Structure**

#### **Organizational Structure**

The Federal Crop Insurance Corporation (FCIC) is a wholly owned government corporation created February 16, 1938 (7 U.S.C. 1501). The program was amended by Public Law (P.L.) 96-365, dated September 26, 1980, to provide for nationwide expansion of a comprehensive crop insurance program.

The Risk Management Agency (RMA) was established under provisions of the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act), P.L. 104-127, signed April 4, 1996. The 1996 Act amended the Department of Agriculture Reorganization Act of 1994 (1994 Act), P.L. 103-354, Title II, by requiring the Secretary of Agriculture (the Secretary) to establish within the U.S. Department of Agriculture (USDA) an independent office responsible for supervision of the FCIC, administration and oversight of programs authorized under the Federal Crop Insurance Act, such as any pilot insurance plans or other programs involving revenue insurance, risk management education, risk management savings accounts, or the use of the futures markets to manage risk and support farm income that may be established under the Federal Crop Insurance Act or other law; and any other programs the Secretary considers appropriate. The Federal Crop Insurance Act as amended through 2002, is hereafter referred to as the Act.

#### **Mission**

The purpose of the FCIC and RMA, (hereafter the combined entities will be referred to as the FCIC), is to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and other risk management tools. Stabilizing rural communities through an actuarially sound system of crop insurance has been an important public policy of the United States for over half a century. The FCIC is committed to transforming yesterday's crop insurance program into a broad-based safety net for producers to assure American agriculture remains solid, solvent, and globally competitive through the twenty-first century.

The objectives include the following items:

- Increase the number of economically sound risk management tools that are available and utilized by producers to meet their needs;
- Increase the agricultural community's awareness of risk management alternatives; and
- Improve program integrity and protect taxpayers' funds.

#### **Regulatory Acts Impacting the FCIC**

The Farm Security and Rural Investment Act of 2002 (2002 Farm Bill) was signed into law on May 13, 2002. Major provisions of this new legislation included: Authorization for sweetpotato insurance to extend beyond the time the crop is in the field (as in the case of tobacco and potatoes) and expansion of the Adjusted Gross Revenue Insurance pilot program into additional counties in California and Pennsylvania.

The President signed the Agricultural Risk Protection Act of 2000 (ARPA) into law on June 20, 2000. Major provisions of this new legislation included: expanded use of contracts and partnerships for the research and development of policies and other risk management tools; revised CAT administrative fees and loss adjustment expense reimbursements; significantly revised premium subsidies; livestock coverage authorization; reimbursement of research, development, and maintenance costs for products submitted to the Corporation; expanded risk management education and assistance; funds to address under-served areas, States, and commodities; an expert review panel and procedures for reviewing policies, plans of insurance, and related material or modifications; improved program compliance and integrity provisions; acceptance of electronic information; provisions specifying that good farming practices include scientifically sound sustainable and organic farming practices; and others not included herein.

### **Business Overview**

Federal crop insurance is available to producers through private insurance companies that market and service policies upon which those companies also share in the risk. The amount of risk they share is defined by reinsurance agreements with the FCIC. Under these agreements reinsured companies agree to deliver risk management insurance products to eligible entities under certain terms and conditions. Reinsured companies are responsible for all aspects of customer service and guarantee payment of premium to FCIC. In return, FCIC reinsures the policies and provides a subsidy for administrative and operating expenses associated with delivering the insurance products and/or programs. FCIC also provides a subsidy for producer's premium. This constitutes a joint effort between the Government and the private insurance industry for program delivery.

Approximately 1.3 million policies were written in crop years 2002 and 2001 with an estimated \$1.21 billion and \$ 1.19 billion in farmer paid premium for crop years 2002 and 2001 and an estimated \$1.79 billion and \$1.77 billion in estimated premium subsidies for crop years 2002 and 2001. For the 2002 and 2001 crop years, an estimated \$4.3 billion and \$3.2 billion were to be paid in indemnities. For 2002 and 2001 crop year, \$ 1.3 billion and \$ .2 billion of appropriations were estimated to be used to pay indemnities in excess of premiums. Crop insurance was available for 88 different commodities (approximately 600 commodities as enumerated for disaster assistance purposes) for crop year 2002 and crop year 2001. Crop year 2002 and 2001 coverage was available in over 3,000 counties covering all 50 states and Puerto Rico.

The FCIC maintains two separate funds, one for administrative and operating purposes (A&O Fund), and one for the crop insurance program (Insurance Fund). The A&O Fund is used to pay salaries and other administrative expenses. The Insurance Fund is used to pay for all types of crop losses. The Insurance Fund also pays for the reinsured companies administrative expenses associated with marketing and fully servicing the crop insurance policies written. Operating expenses of the reinsured companies are reimbursed by the FCIC. The premium costs of insured persons are also subsidized. The FCIC encourages future crop insurance participation by offering premium discounts to purchasers of crop insurance.

The reinsured companies process insurance documents, bill and collect premiums, and pay losses according to stipulations within the insurance policy and reinsurance agreement with the FCIC. The reinsured companies electronically transmit to the FCIC,

at least monthly, all data required under the reinsurance agreement in order to receive their contracted reimbursements. R&D divisions assist in processing all insurance data, record detailed accounting and statistical data, prepare the required accounting, statistical, and management reports for business from all sources, and collect all crop and accounting data needed for policy determinations, underwriting decisions, and financial management.

Ten regional offices formulate and recommend policies specific to the needs of the region for which each is responsible. They provide customer service, problem identification, resolution and/or referral, as well as assistance to delivery system partners regarding program issues related to underwriting and claims administration.

Six regional compliance offices provide assurance of program integrity by conducting program reviews and audits to assure mandates, policies and procedures are effective and are followed by persons involved in delivering crop insurance. The six field offices also conduct investigations into complaints alleging fraud or abuse of existing insurance programs. This ensures fair and equitable treatment of the farmer, taxpayer, and the FCIC.

### **Federal Crop Insurance Program - Activities**

The Federal crop insurance program comprises the following major activities:

- (1) Program Management includes the FCIC Board of Directors, the RMA Administrator's office and staff offices that report directly to the RMA Administrator.
- (2) Research and Development (R&D) involves the design and development of crop insurance programs, policies and standards, and the establishment and maintenance of rates and coverages for crops in each county. This activity also includes: 1) analysis of insurance experience and risk; 2) evaluation and establishment of setting crop insurance price elections; 3) production and dissemination of actuarial data, documents, and files; 4) the evaluation of current crop insurance plans and policies; and 5) development of strategies for increasing participation in the crop insurance program. This function handles products submitted under section 508(h) of the Act that must be reviewed and evaluated and if enacted, must be deployed and maintained like other risk management products. With the passage of the Agricultural Risk Protection Act of 2000, effective fiscal year 2001, these design and development of crop insurance programs are now done through contracts and partnerships with other organizations under RMA's oversight.
- (3) Insurance Services has responsibility for delivering FCIC programs through a system of ten Regional Offices and reinsured companies. It provides support, information, and advice to the Office of the Administrator; delivers risk management education programs to producers through private and public education partners; coordinates FCIC responses to emergency situations; maintains existing FCIC products through field underwriting assessments; assists in new product development; and supports FCIC civil rights and outreach initiatives. Headquarters staff complement field activities by ensuring consistent application of actuarially sound insurance principles in field-level underwriting and by monitoring a uniform system of loss adjustment.

(4) Compliance provides program oversight and quality control of the reinsured companies. It ensures the integrity of the crop insurance program through reviews of reinsured companies' operations and ensures the delivery of crop insurance is in accordance with applicable laws, regulations, and procedures.

## **Federal Crop Insurance Program – Insurance Plans**

### **Revenue Crop Insurance Plans**

Crop Revenue Coverage (CRC) was developed by a private insurance company and first submitted to the FCIC Board for approval in 1995 for the 1996 crop year. Revenue Assurance (RA) was developed by another private insurance company and submitted to the FCIC Board for approval in 1996 for the 1997 crop year. Income Protection (IP) was developed in 1997 by the FCIC. These plans respond to the directive of the 1994 Act which directed the FCIC to develop a pilot crop insurance program which provided coverage against reduced gross income as a result of a reduction in yield or price, and has generally been improved and/or expanded each year. The FCIC Board of Directors approved, for the 1999 crop year, a fourth plan, Group Risk Income Protection (GRIP), submitted by another private company.

CRC, RA, and IP have many similar features. They guarantee revenue by insuring yield and price variability. Indemnities are due when any combination of yield and price result in revenue that is less than the revenue guarantee. CRC, RA, and IP plans are similar because they use many of the same policy terms and conditions of the MPCCI plan of insurance that uses Actual Production History (APH). APH provides the yield component and provides a yield forecast through the insureds records of historic yields. It also provides a documented process to determine the yield for the insurance period.

GRIP offers producers a guarantee against decline in county revenue, which is based on the Chicago Board of Trade futures prices and National Agricultural and Statistics Service county yields as adjusted by the FCIC. The GRIP policy provides coverage on an enterprise unit basis. The amount of any loss will be finalized when the final county yields and harvest price are known in the spring following the crop year. The GRIP policy contains no replant, late, or prevented planting provisions.

Revenue protection for all products is provided by extending traditional MPCCI protection based on APH to include price variability. The price component common to the CRC, RA, IP, and GRIP plans is that these plans use the commodity futures market for price discovery. Price discovery occurs twice in the CRC, RA, IP and GRIP plans: first, before the insurance period (Projected, Base or Expected Price) to establish the revenue guarantee and premium, and second, at harvest time (Fall Harvest Price, Harvest Price). CRC provides increased protection when the Harvest Price is above the Base Price. The RA plan of insurance has the Fall Harvest Price Option available. If selected by the producer, it provides increased protection when the Fall Harvest Price is greater than the Projected Harvest Price. All revenue insurance plans pay the insured producer an indemnity when any combination of harvested and appraised yield and Harvest Price (Fall Harvest Price) results in insurance revenue that is less than the revenue guarantee.

### **Crop Revenue Coverage (CRC) Insurance plan:**

For the 2003 crop year, the CRC plan of insurance will offer coverage for corn in 47 states, cotton in 17 states, grain sorghum in 29 states, rice in 9 states, soybeans in 32 states, and wheat in 35 states.

### **Income Protection (IP):**

Income Protection is designed to protect producers against reductions in gross income when either a crop's price or yield declines from early-season expectations. For the 2003 crop year, the IP plan of insurance will offer coverage for barley in 7 states, corn in 3 states, grain sorghum in 1 state, soybeans in 4 states, and Wheat in 8 states.

### **Revenue Assurance (RA):**

For the 2003 crop year the RA plan of insurance will provide coverage for feed barley in 2 states, malting barley in 1 state, canola/rapeseed in 2 states, corn in 15 states, cotton in 5 states, soybeans in 15 states, sunflowers in 1 state, rice in 2 states, spring wheat in 6 states and winter wheat in 13 states.

### **Group Risk Income Protection (GRIP):**

The Board voted to expand the GRIP program to Michigan and Ohio for the 2003 crop year. The GRIP program was expanded to all counties in Michigan and Ohio that have been approved for GRP coverage for corn and soybeans. The expansion will add 36 GRIP corn counties and 34 GRIP soybean counties in Michigan, and will add 61 GRIP corn counties and 52 GRIP Soybean counties in Ohio. Coverage will be extended to approximately 210,000 acres of corn in the two states and approximately 200,000 acres of soybeans.

### **Revenue Products Approved for 2002 under section 508(h) of the Act**

The following crop insurance products were submitted by private companies under the provisions of section 508(h) of the Act and approved by FCIC for the 2002 crop year:

- Hybrid Seed Price Endorsement (HSPE) - HSPE is written with a Hybrid Seed Corn crop insurance policy and uses a corn price derived from the Chicago Board of Trade futures price to calculate the amount of insurance. HSPE is available in Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Nebraska, and South Dakota.
- Livestock Gross Margin (LGM) – LGM provides coverage for the difference between the Actual Total Gross Margin (actual swine price less feed costs as determined using corn and soybean meal futures settlement prices at the Chicago Board of Trade) and the Gross Margin Guarantee (Chicago Mercantile Exchange lean hog futures price less the price of feed based on the Chicago Board of Trade



futures price for corn and soybean meal) and not for death or other loss or destruction of swine.

- Livestock Risk Protection (LRP) - LRP allows producers to pay premium for a specific number of hogs, rather than requiring the producer to purchase a set contract size as is required for both futures and options contracts. Producers can purchase coverage for a period consistent with his or her own time of marketing, rather than simply using the available contract months specified by the commodity exchanges.
- LGM and LRP have been available for a little more than three months. As of October 21, 2002, LGM and LRP have insured 208,415 head or .014 percent of the swine in Iowa. Total premium for both plans is \$851,483 and total exposure is \$11,800,533 with an expected loss ratio of 33 percent. This is the first year for both products and RMA anticipates that sales will increase as producers become more aware of these products.
- Nutrient Best Management Practice (N-BMP) - The N-BMP insurance policy provides insurance protection from crop production loss when a producer applies a rate of fertilizer (nitrogen and/or phosphorus) recommended by a Best Management Practice (BMP). Except for fertilizer, producers must use the same farming practices on both the check strip and management unit. Based on an appraisal, if the production per acre on the check strip is greater than adjacent strips within the management unit, less a deductible (5 percent), the producer receives an indemnity.

### **Yield based (APH) Insurance Plans**

#### **Multiple Peril Crop Insurance (MPCI)**

These policies insure producers against losses due to natural causes such as drought, excessive moisture, hail, wind, frost, insects, and disease. The farmer selects the amount of average yield he or she wishes to insure; from 50 to 85 percent. The farmer also selects the percent of the predicted price he or she wants to insure; between 55 and 100 percent of the crop price established annually by RMA. If the harvest is less than the yield insured, the farmer is paid an indemnity based on the difference. Indemnities are calculated by multiplying this difference by the insureds percentage of the established price selected when crop insurance was purchased.

#### **Group Risk Plan of Insurance (GRP):**

The Group Risk Plan (GRP) was created by FCIC as a risk management tool to insure against widespread loss of production of the insured crop in a county. It is primarily intended for use by those producers whose farm yields tend to follow the average county yield. Producers may select a coverage level of 65 percent for Catastrophic Risk Protection (CAT), or a percentage ranging from 70 to 90 percent for buy-up coverage. The producer's coverage level percent is multiplied by the expected county yield shown on the actuarial documents to determine the trigger yield. If the payment yield that FCIC publishes for the insured crop year falls below an insured's trigger yield, they will receive a payment.

Producers may select a dollar amount of protection between 60 and 100 percent (except for CAT which is 45 percent) of the maximum protection per acre shown on the actuarial documents. This protection is provided for each acre of the crop planted by the acreage reporting date and shown on a producer's acreage report. The premium rates, practices, types, maximum protection per acre, and maximum subsidy per acre are also shown on the actuarial documents.

FCIC issues the payment yield in the calendar year following the crop year insured. This yield is the official estimated yield published by the National Agricultural Statistics Service (NASS). Producers are paid if the payment yield falls below their trigger yield. The amount of payment per net insured acre is calculated by subtracting the payment yield from the trigger yield, dividing that quantity by the trigger yield, and multiplying that result by the producer's protection per acre for each net acre insured.

Covered crops currently include: barley, corn, cotton, forage, peanuts, sorghum, soybeans, wheat, and rangeland. All GRP crops are permanent programs, with the exception of rangeland, which remains a pilot program. For the 2002 crop year, one or more GRP crop programs were offered in 23 states. There were a total of 15,518 policies sold nationwide. The most policies were sold in Wisconsin with 2,197. Other states with significant GRP participation include: Illinois, Indiana, Iowa, Kentucky, Michigan, Ohio, and Tennessee. The total acreage insured under GRP for 2002 was 11,163,606, with a total liability of \$992,258,241, and premium of \$32,292,788.

### **Dollar Plan**

The dollar plan provides protection against declining value due to damage that causes a yield shortfall. The amount of insurance is based on the cost of growing a crop in a specific area. A loss occurs when the annual value of the crop is less than the amount of insurance. The dollar plan is available for several crops, including fresh market tomatoes, strawberries, and cherries (on a pilot program basis in limited areas only).

### **Pilot Programs**

The FCIC currently has 32 pilot programs underway that implement legislation or test new and innovative crop insurance concepts. Pilot insurance plans and other risk management tools available for the 2003 crop year include Adjusted Gross Revenue, apple pilot quality option, avocado actual production history, avocado revenue, avocado/mango trees, blueberries, cabbage, cherries, citrus (dollar), corn rootworm integrated pest management, coverage enhancement option, crambe, cultivated clams, cultivated wild rice, dairy options, Florida fruit trees, forage seed, fresh market beans, the Income Protection (IP) plan of insurance, mint, mustard, onion pilot stage removal option, pecan revenue, processing chile peppers, processing cucumbers, rangeland (GRP), raspberry/blackberry, strawberries, sweetpotatoes, and winter squash (including pumpkins). In addition, two pilot programs were initiated beginning in 2002 under the provisions of section 508(h) of the Act (policy submissions to FCIC): the livestock gross margin pilot program and the livestock risk protection pilot program.

## **Increase Participation and Program Growth**

The FCIC continues to encourage producer acceptance and program participation through outreach and educational activities directed at informing the agricultural community of the “new risk environment” and how crop insurance is one component that can be used to mitigate potential losses. The FCIC’s goals include ensuring that producers have sufficient information to adequately assess their own risk in today’s uncertain agribusiness environment. Activities include participation in agricultural related events and expositions around the country and distributing the crop insurance industry’s guide entitled, “Managing Risk - Being Prepared” Outreach and education on the crop insurance program and other risk management tools will increase under the mandate found in the 1996 Act.

The 1996 Act directs the development of risk management education and conducting an options pilot program. The risk management focus will provide education about the management of financial risks inherent in the production and marketing of agricultural commodities. The options pilot program will facilitate the participation and education of producers in commodity futures trading programs and forward contract options. Both initiatives will train producers in the use of insurance programs and options as tools and strategies for their farming operations. The options pilot program is designed to be budget neutral to the extent feasible, which limits its potential for wide use.

## **Risk Management Education**

RMA continues to partner with the Cooperative State Research, Education, and Extension Service (CSREES), the Commodity Futures Trading Commission (CFTC), and the USDA National Office of Outreach, to provide Risk Management Education (RME) to U.S. farmers and ranchers, as mandated in Section 192 of the 1996 FAIR Act. In addition, the Agricultural Risk Protection Act of 2000 significantly increased RMA’s role in delivering education and outreach programs.

The RME Division provides farmers with information and with educational opportunities to become more aware of risk, know the tools available to manage risk, and learn strategies for making sound risk management decisions.

The following are highlights of RME Activities for fiscal year 2002:

*Producers trained.* The number of producers trained locally in risk management tools and skills as a result of RME-sponsored activities during 2002 fiscal year is estimated to be 35,000.

RMA seeks to increase the agricultural community’s awareness of risk management alternatives through education and information programs, an effort that was bolstered significantly with the passage of ARPA. ARPA provided RMA with the opportunity to expand its educational programs on several fronts.

- *Risk Management Education for Specialty Crops.* ARPA directs RMA to establish partnerships for the purpose of providing producers of specialty crops and under-served commodities with risk management training.
- *Crop Insurance Education for Targeted Region States.* ARPA authorizes and directs RMA to establish crop insurance education and information programs in states that have been historically under-served by the Federal crop insurance program. The 15 states designated by the Secretary that are eligible for this program are Maine, New Hampshire, Vermont, Connecticut, Massachusetts, Rhode Island, New York, New Jersey, Pennsylvania, Delaware, Maryland, West Virginia, Utah, Nevada, and Wyoming.
- *Competitive Grants for Risk Management Education.* This is a cross-cutting program administrated by the Cooperative State Research, Education, and Extension Service (CSREES) using funding from the Federal Crop Insurance Fund.
- *Dairy Options Pilot Program (DOPP)* . ARPA significantly expanded RMA's option pilot program authority. RMA is now operating DOPP in 300 counties across the U.S.
- *Agricultural Management Assistance (AMA) Program.* This is another cross-cutting program authorized by ARPA that RMA administers jointly with the Natural Resource Conservation Service and the Agricultural Marketing Service.

### **Performance Goals, Objectives, and Results**

The key performance goals and results that follow were selected from RMA's revised fiscal year 2002 and initial fiscal year 2003 Annual Performance Plan and RMA's Strategic Plan for fiscal years 2000-2005.

#### **Strategic Goal: To strengthen the safety net for agricultural producers through sound risk management programs and education.**

The FCIC develops and delivers (in coordination with and through the private sector) a variety of risk management products to enable agricultural producers to manage their risks. These products help producers protect themselves from yield risks, market risks, or other risks faced in their farming operations. The FCIC's new legislative initiatives resulting from the passage of the ARPA further contribute to producers' ability to protect their financial stability, and comprise the major component of the safety net for agricultural producers. The ARPA includes significant changes in the manner in which the FCIC accomplishes its goal, including expanded use of contracts and partnerships. These changes will expedite and strengthen the research and development process to enable new and innovative risk management tools to be utilized by producers. These tools go far beyond traditional crop insurance programs which in the past, have been the primary focus of the FCIC. These efforts, and the resulting new FCIC tools for producers will truly enable the FCIC to achieve its vision of transforming yesterday's crop insurance program into a broad-based safety net for producers through the 21<sup>st</sup> century. An expanded, comprehensive risk management education and outreach program will increase

agricultural producers' awareness of their new and improved risk management opportunities. The FCIC's goal provides a solid foundation and direction for the future and is directly linked to the Secretary's Overview on Goal 1.1, "Provide an effective safety net and promote a strong and sustainable U.S. farm economy."

**Objective: 1.1 Increase the availability and utilization of economically-sound risk management tools to meet producers needs.**

Producers' needs are continuously being assessed by the FCIC and its private sector partners to ensure new and innovative risk management alternatives are available to meet producers' needs.

**Strategies for Achieving the Objective**

1. Assess needs and interest for risk management tools for producers of specific agricultural commodities.
2. Lead the contracting and partnership efforts to assist agricultural partners in the research, development, implementation, and maintenance of new tools such as revenue coverage, underserved commodities and areas, specialty crops, livestock, cost of production plans, and other non-traditional risk management products.
3. Maintain and continuously improve existing products.
4. Evaluate products and take appropriate actions.
5. Evaluate and improve process for private companies submitting and gaining approval/disapproval of alternative products.

**Performance Goal and Indicators:**

The following outcomes assess the effectiveness of the FCIC's contribution to the safety net for agricultural producers through utilization of risk management tools related to increasing the availability and utilization of economically-sound risk management tools to meet producers needs.

	Crop Year <sup>1</sup> 1999 Actual	Crop Year <sup>1</sup> 2000 Actual	Crop Year <sup>1</sup> 2001 Actual	Crop Year <sup>1</sup> 2002 Estimated
<b>Performance Goal:</b> Increase the availability and utilization of economically-sound risk management tools to meet producers needs.				
<b>Indicators:</b>				
Net acres insured (acres in thousands) 2005 Target = 226,163 acres insured	196,377 <sup>2</sup>	206,444 <sup>2</sup>	211,810 <sup>2</sup>	221,386
Number of insurance plans available (crop year data). 2005 Target = 149 insurance plans	138	146	147	149
Total insurance in force (dollars in thousands). 2005 Target = \$42,175,500 insurance in force	30,864,958	34,436,731 <sup>2</sup>	36,730,027 <sup>2</sup>	37,243,917
Total crop insurance premium (dollars in thousands). 2005 Target = \$3,743,900	2,304,695	2,540,022 <sup>2</sup>	2,961,225 <sup>2</sup>	3,000,000
Loss Ratio	105.00	102.00	98.92	142.00
Participation rate for acres covered by revenue insurance plans (percent) <sup>3</sup>				
- Under-served States	8.2	18.2	23.8	23.9
- Nationwide	27.0	31.8	42.2	42.4

**Objective 1.2: Increase the agricultural community's awareness of risk management alternatives.**

Through contracts and partnerships, the agricultural community will have available a comprehensive risk management education and outreach program. The FCIC will provide leadership, funding, and a strategy for institutionalizing this risk management program.

**Strategies for Achieving the Objective:**

1. Enhance the process to identify and reach underserved areas, States, commodities, producers, and other members of the agricultural community (e.g., farm publications, education courses, etc.).
2. Prepare and deliver Risk Management Education (RME) products.

**Performance Goal and Indicators:**

The following outcomes assess the effectiveness of the FCIC's contribution to the safety net for agricultural producers through utilization of risk management tools related to increasing the agricultural community's awareness of risk management alternative.

<sup>1</sup> For most crops, crop year is defined as: The period within which the insured crop is normally grown and designated by the calendar year in which the insured crop is normally harvested.

<sup>2</sup> Reflects actual to date. Source: 10/21/2002 FCIC Summary of Business Report.

<sup>3</sup> Revenue plans: CRC, GRIP, IP, RA -- Underserved States: CT, DE, ME, MD, MA, NH, NJ, NY, NV, PA, RI, UT, VT, WV, WY.

	FY 1999 Actual	FY 2000 Actual	FY 2001 Actual	FY 2002 Estimated
<b>Performance Goal:</b> Increase the agricultural community's awareness of risk management alternatives.				
<b>Indicators:</b>				
Number of producers participating in RME activities being coordinated or facilitated by RMA throughout the U.S.	14,500	30,095	40,232	49,149
Total number of crop insurance policies in force (in thousands – crop year to date)	1,285	1,286	1,298	1,300
Total number of RME sessions being coordinated or facilitated throughout the U.S.	950	1,200	1,500	1,198

### **Objective 1.3: Improve program integrity and protect taxpayer's funds.**

This objective is achieved by conducting internal and external reviews, investigations, program evaluations, and audits to address inherent program vulnerabilities, deter abuse, and minimize program costs. This will be done in coordination with private sector delivery partners, oversight bodies, and appropriate contracts and partnerships with others.

#### **Strategies for Achieving the Objective:**

1. Develop and maintain a system to continually evaluate and improve internal and external management controls.
2. Expand the use of contracts and partnerships in the evaluation of new and existing risk management tools, including the implementation of an expert panel to review products before they are sent to the FCIC Board of Directors, in accordance with the requirements of ARPA.
3. Implement the process identified in the Concurrence Process and Signature Authorities memo signed by the RMA Administrator to the Deputy Administrator for Research and Development on October 4, 2000, to ensure adequate review and concurrence of new risk management tools.
4. Review, improve, and maintain performance standards for delivery partners.
5. Implement and maintain a process to ensure evaluation of financial performance measures of various reinsurance agreements.
6. Develop and apply data mining and other state-of-the-art technology to compliance methodology.

### **2002 and 2001 Crop Year Performance Measurements**

The FCIC's total estimated premium level for its reinsured business was \$3.0 billion for the 2002 crop year, with insured producers paying \$1.21 billion and the remaining \$1.79 billion paid in premium subsidies and EFA discounts. The FCIC provided approximately \$37.2 billion of insurance protection on about 1.3 million policies for approximately 836,000 insureds. These crop policies provide coverage for over 221.4 million acres,

which are approximately 77.7% of the insurable acres nationwide. For the 2002 crop year policies, the FCIC estimates that approximately \$4.3 billion of indemnities will be paid to insureds on approximately 292,000 indemnity claims. For crop year 2001 policies, the FCIC paid approximately \$2.945 billion to insureds on approximately 356,000 indemnity claims. The loss ratio for 2002 is estimated to be 142.00% compared to the FCIC's actual loss ratio of 98.92% in 2001.

The FCIC has pursued several initiatives to improve actuarial soundness and contain costs within the MPCl program. The FCIC has steadily followed direction provided by the Act, to increase the share of risk to private insurance companies. Also, the FCIC has gradually reduced the rate of reinsured company administrative expense reimbursement. FCIC continues to work with the private insurance industry to review issues under contract. The objectives of this effort include:

- To seek changes which will strengthen the program through greater participation,
- To determine more accurately the approximate cost of required activities to effectively deliver crop insurance,
- To identify currently required activities that may be prudently eliminated, and
- To identify activities which can be accomplished more efficiently.

The FCIC has increased the risk to private sector in the reinsurance agreement since passage of the Act. Following the major losses of the 1993 crop year when reinsured companies lost approximately \$83 million, the FCIC elected to make only minor changes to the reinsurance agreement so the FCIC could observe the performance of the reinsurance agreement under less severe conditions. The reinsured companies' underwriting gains in 2001 crop year were \$341.8 million, and due to the estimated 142.00 loss ratio for 2002 crop year, the reinsured companies underwriting losses are estimated to be \$212.2 million.

#### 1993-2002 Crop Years in Retrospect

An overall review of the period 1993 crop year through 2002 crop year reveals a substantial change in delivery of the MPCl product and unusually turbulent weather patterns. The FCIC's authorizing legislation was amended prior to 1990 fiscal year to improve its ability to administer an actuarially sound program. In 1995, farmers were required to purchase crop insurance in order to obtain linkage to other USDA programs. This is the reason for the substantial premium increase from 1994 crop year to 1995 crop year. In the 2000 crop year premium also increased substantially due to \$400 million in premium discounts being offered to producers.



10 Year Summary of Premiums and Losses  
(in millions)

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>10 Yr. Total</u>
Premiums	756	950	1,542	1,837	1,775	1,879	2,304	2,540	2,961	3,000	19,544
Losses	1,655	598	1,566	1,487	991	1,673	2,420	2,591	2,949	4,200	20,130
Loss Ratio											103%

For the crop years 1993 through 2002, the program has paid out an average of \$1.03 for every dollar of premium. In addition to the cost of the excess losses, administrative expenses of the program and premium subsidy have averaged \$478 million and \$1,014 million, respectively, over the past ten years. Premium subsidies have increased significantly since the 1995 crop year due to the 100% subsidization of catastrophic insurance premiums by the U.S. government.

There are significant efforts underway that have shown early signs of loss ratio improvements, such as implementation of the nonstandard classification system (NCS), Group Risk Protection (GRP), and the analysis of premium rates as discussed under the "2001 Program Performance" section.

### **2002 and 2001 Fiscal Year Financial Performance**

Premium revenue is comprised of producer paid premium and premium subsidy appropriated by the federal government. Producer paid premium is recognized as earned ratably over each crop's growing season and is stated net of the underwriting gains/losses, which will be returned to the reinsured companies. The portion of producer premium not recognized at the conclusion of the fiscal year is classified as unearned revenue in the consolidated balance sheet. Premium subsidy is recognized as earned when expended. The unexpended premium subsidy remains an unexpended appropriation in the consolidated balance sheet.

The sum of producer paid premium and premium subsidy has been calculated using generally accepted actuarial methods to attain a break-even loss ratio of 100%. Premium subsidy is not considered written to the extent a portion remains unexpended and no unearned revenue is recorded in the consolidated balance sheets. As a result, the expected claim costs and claim adjustment expenses exceed the related unearned revenue. A premium deficiency is therefore recognized in the consolidated balance sheet by accruing a liability recorded as an other liability for the excess amount.

The following are measures of the FCIC's financial performance:

<u>Net Operating Cost</u>		
(in millions)		
	2002	2001
Total Program Costs	\$ 4,665	4,138
Less Earned revenues	(1,199)	(976)
Net cost of operations	\$ 3,466	3,162

The previous measure indicates the FCIC's net operating cost. The increase in net operating costs was primarily due to the increase in estimated losses from crop year 2001 to crop year 2002.

<u>Operating Results</u>		
(in millions)		
	2002	2001
Beginning Balance	\$ 82	\$ (58)
Change in Accounting Method	(319)	--
Beginning Balance, as Adjusted	(237)	(58)
Appropriations and other financing sources used	3,025	2,983
Less net cost of operations	(3,466)	(3,162)
Net change in Cumulative Results of Operations	\$ (678)	\$ (237)

The previous measure indicates that future funding will be required for the 2002 fiscal year and that net operating costs were essentially financed by appropriations in 2001 fiscal year.

Financial Obligations

(in millions)

		2002	2001
Entity Assets	\$	3,710	3,635
Liabilities covered by budgetary resources	\$	3,519	2,902
Ratio of entity assets to liabilities covered by budgetary resources		1.05	1.26

Net Position

(in millions)

		2002	2001
Total assets	\$	3,710	3,635
Total liabilities		(3,519)	(2,902)
Net Position	\$	191	733

The above measures provide an indication of the net position of the FCIC as of September 30, 2002 and 2001. The primary reason for the decrease of the ratio of entity assets to liabilities covered by budgetary resources as well as the net position is the FY 2002 increase in estimated indemnities.

**Financial Highlights**

The FCIC has prepared its financial statements in accordance with the accounting standards codified in the Statements of Federal Accounting Standards and the Form and Content requirements contained in the Office of Management and Budget (OMB) Bulletin 01-09 and its updates.

## **Financial Statements**

### **Limitation on Financial Statements**

The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the statements are in addition to the reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are a component of the U.S. Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources to do so.

### **Consolidated Balance Sheet**

The FCIC's total assets as of September 30, 2002 were \$3.7 billion and as of September 30, 2001 were \$3.6 billion. The Fund Balance with Treasury and Accounts Receivable Net, are 96.9 and 97.0 percent, respectively, of total assets. The Liability for Estimated Losses on Insurance Claims, \$2.9 billion in FY 2002 and \$1.9 billion in FY 2001, respectively, are approximately 82 percent of total liabilities in FY 2002 and 65 percent of total liabilities in FY 2001.

### **Statement of Net Cost**

The FCIC's net cost of operations for FY 2002 was \$3.5 billion, a 9.6 percent increase over the FY 2001 net cost of operations that was \$3.2 billion. The indemnity costs and program delivery costs are 97.6 percent of the FCIC's cost of operations in FY 2002 and 98.0 percent in FY 2001.

### **Statement of Net Position**

The net cost of operations of the corporation increased in FY 2002. This was due to an increase in the estimated losses. Our loss ratio was an actual 99 percent in FY 2001 and an estimated 142 percent in FY 2002.

## Statement of Budgetary Resources

Appropriations, combined with other budgetary resources made available and adjustments totaled \$5.0 billion in FY 2002 and \$4.8 billion in FY 2001, while total outlays were \$3.0 billion in FY 2002 and \$ 2.5 billion in FY 2001.

<u>Budgetary Resources</u>			
(in millions)			
		2002	2001
Appropriations	\$	2,894	3,467
Unobligated balance brought forward		1,234	409
Offsetting Collections and Adjustments		835	920
Total	\$	4,963	4,796

## Statement of Financing

The total budgetary and non-budgetary resources used to finance operations totaled \$3.5 billion in FY 2002 and \$3.2 billion in FY 2001, of which \$1 million in FY 2001 and \$36 million in FY 2002 were items not part of the net cost of operations.

## Systems, Controls, and Legal Compliance

### Risk Compliance

The focus of the compliance function continues to ensure the integrity of the crop insurance program and its delivery by increasing effectiveness, efficiency and timeliness of reviews performed on the companies which participate in the delivery of MPCl.

ARPA mandated new requirements in the areas of program compliance and integrity but the act did not cause a change to Risk Compliance's overall mission, goals, or business objectives. Instead ARPA impacted existing business processes and provided additional management tools.

The role of Risk Compliance is to ensure that laws, policies, and procedures are followed and administered effectively. Risk Compliance seeks to maintain program integrity. This is accomplished through a systematic review process for the detection and prevention of crop insurance program abuse. Properly done, this requires a proactive approach in which the FCIC and the industry work together to increase awareness, develop programs, identify systems and processes, and take other actions to minimize the potential for crop

insurance program abuse. Such an approach is ultimately aimed at the proactive prevention of fraud and abuse, rather than reactive.

Risk Compliance's goal is to reduce taxpayer and producer burden generated by fraud and abuse, contract noncompliance, and program vulnerabilities. The reinsured companies counter fraud and abuse in program delivery by performing growing season inspections, reviewing reported producer yields, performing on sight inspections, avoiding conflicts of interest, and initiating and engaging in litigation on issues important to the MPCCI program. The reinsured companies are also an important source of information concerning program vulnerabilities.

Risk Compliance's efforts are focused on investigation work generated by Office of the Inspector General (OIG) Hotline complaints, a variety of other external sources, and National Operations Reviews (NOR) of companies to determine compliance with the Standard Reinsurance Agreement (SRA) requirements and to determine MPCCI program vulnerabilities.

Ultimately, Risk Compliance produces a positive impact on MPCCI program integrity through its findings of noncompliance. Risk Compliance provides information and evidence to the FCIC Contracting Officer and other key operating and policy elements of the FCIC. This material provides a basis for action against wrong doers and for MPCCI program modification. Risk Compliance works with the Department of Justice through the USDA OIG's criminal division and the Office of General Counsel (OGC) (civil) where matters indicate a need for litigation.

### **Federal Managers' Financial Integrity Act**

The FCIC takes measures to conduct self-assessments, identify material weaknesses, and implement timely corrective action through the annual Federal Managers' Financial Integrity Act (FMFIA) reporting process.

The FCIC addresses audit findings and recommendations timely and works closely with the OIG, GAO, OCFO, Department of Justice (DOJ), and Assistant US Attorneys (AUSA) to timely implement effective, responsive corrective actions and improvements.

The compilation of these activities has enabled FCIC to identify and reduce program vulnerabilities, which has contributed to improved program integrity and protection of taxpayer's funds. A reduction in program vulnerabilities, improved program integrity, and protection of taxpayer's funds, in turn, enhance the economic safety net for farmers and ranchers.

The Federal Financial Management Improvement Act (FFMIA) requires that agencies implement and maintain financial management systems that comply substantially with federal financial management system requirements, applicable federal accounting standards, and the U.S. government standard general ledger at the transaction level. During its financial statement audit, the OIG and independent auditors report on whether or not financial management systems comply substantially. If the systems do not, then a plan is required to bring the systems into compliance.

Through review of its programs and the use of OIG and GAO evaluations, RMA strives to ensure government resources are used efficiently and effectively to achieve the

intended program results. Improvement to programs following these reviews are designed to further minimize the potential for waste, fraud, and mismanagement.

### **Agricultural Risk Protection Act of 2000**

The Agricultural Risk Protection Act (ARPA) of 2000, Section 515, mandated new requirements in the area of program compliance and integrity. These new requirements once fully implemented should enhance management information systems and facilitate the detection and enforcement of program fraud, waste, and abuse.

With the resources provided in the ARPA for data warehousing, data mining and other information technology capabilities, RMA continues to improve its compliance enforcement capabilities and reduce overall program vulnerabilities. Cooperative agreements and contracts are in place to greatly supplement this already existing effort in incremental phases over the next 5 years. Using the trends, indicators and analyses provided by these systems, we will be more proactive and aggressive in managing and monitoring program integrity issues.

RMA has entered into a contractual agreement to establish a pattern recognition system, enabling the Agency to identify trends signaling poor performance and/or potential/actual fraud, waste, and abuse of resources. The objectives of the contract are to identify trends, patterns, anomalies and relationships between reinsured organizations, insurance agents, adjusters, and producers in crop insurance data indicative of excess claim adjustment over actual crop loss. The vendor shall incorporate Data Analysis and Data Mining techniques to accomplish this objective. Implementation of this system will enable the Agency to target review efforts in those areas deemed the most vulnerable, thereby enhancing program integrity and protecting taxpayers' funds. To manage both the increased span of control within the internal components of the agency and to ensure unity of authority without compromising the necessity for decentralized operations, RMA reviewed and updated its delegations of authority from the Administrator to the Deputy Administrator for Compliance. The revised delegation provides for the separation of authority at the various levels within Compliance that ensures that the processes for reviews and investigations, adjudication and appeals provides for administrative due process and are conducted fairly and impartially. By tailoring its management functions to meet and exceed the requirements of ARPA, RMA maintains the integrity of the compliance business processes and in doing so, is in a better position to maintain the integrity of crop insurance programs.

RMA conducts reviews designed to evaluate reinsured company performance, detect and correct program vulnerabilities, and collect underpaid premiums and overpaid indemnities. We also conduct investigations into complaints and allegations received from various sources such as producers, agents, and OIG hotline.

RMA's key partner in maintaining program integrity are the reinsured companies. We will continue to foster these relationships while emphasizing the need for the companies' quality control programs to improve and assisting the companies in that improvement process. Our objective is to develop within the companies the same stewardship of taxpayer's funds as our own values and beliefs.

As RMA implements the many changes specified and implied by ARPA requirements over the next several years, the agency will maintain close liaisons and partnerships with other government agencies and private sector companies to keep abreast of technological changes and innovative best practices especially in the areas of combating insurance fraud, investigative tactics and techniques, information management systems, or any other worthwhile venture that may assist the agency in its quest to save the taxpayers' dollars.

Our auditors have communicated a material weakness as it relates to our internal control process over monitoring the reinsured organizations. While management does not agree with the findings of our auditors, the company will investigate and improve the internal controls if and when appropriate.

### **Actuarial and Underwriting Performance**

The systematic adjustment of premium rates and coverage's by the FCIC is producing additional cost savings for the federal government by reducing crop losses and placing the MPCCI program on a more actuarially sound basis. These annual adjustments were initiated beginning with the 1991 crop year as a result of the Act and have stabilized the financial performance of the crop insurance program. The FCIC adjusts premium rates as necessary and appropriate for actuarial soundness. Annual premium rate increases are limited by law to no more than 20%. If rate increases greater than 20% are necessary for actuarial soundness, the FCIC will move toward the target rates over the following years, thus adhering to the 20% rule, but still moving toward the actuarially sound target rate.

The FCIC continues to review the premium rate making methodologies to increase the integrity and performance of the crop insurance program. In addition, the Economic Research Service (ERS), an agency of the USDA, is reviewing the FCIC's crop insurance program rates, financial elements of the standard reinsurance agreement, and yield coverage. Independently, the ERS has entered into a cooperative agreement with the actuarial firm of Milliman and Robertson to review the FCIC's actuarial processes. Additionally, the ERS provides feasibility studies of crops that represent opportunities for expansion of the crop insurance program. The FCIC also uses the resources of the CSREES to provide information about the financial situation of farmers so the FCIC can make more informed decisions for program improvement. During fiscal years 2001, 2002, and 2003, the FCIC has issued several contracts for completion of actuarial studies that will be evaluated and implemented to modify, update, and enhance actuarial methodology and the ratemaking process.

### **Actual Production History Underwriting**

The FCIC's Actual Production History (APH) underwriting procedure of MPCCI requires APH guarantees to be calculated with emphasis on the producer's actual yield records versus proxy yields. Yield guarantees are calculated using 4 years of actual records, building to a 10-year database. For producers who do not provide 4 years of actual yield records, the yield guarantee is a percentage of the proxy yield, which is calculated for each year's missing yield record. The percentage of the proxy yield is 100% when 3 years of records are provided, 90% for 2 years, 80% for 1 year, and 65% when no records are provided. New producers of crops who do not have records of actual yields may use 100 percent of the proxy yield. For APH yield calculation purposes, ARPA allows producers to substitute 60 percent of the applicable proxy yield for actual yields that are less than 60 percent of the applicable proxy yield to mitigate the effect of catastrophic years. Insureds may elect the APH Adjustment and substitute 60 percent of the applicable proxy yield for low actual yields caused by drought, flood, or other natural disasters.

### **Policyholder Tracking System**

The FCIC's Policyholder Tracking System (PHTS), a process within the DAS, uses the policyholder's Social Security Number (SSN) or Employer Identification Number (EIN) to track the policyholder's insurance history. The FCIC utilizes the PHTS to create a

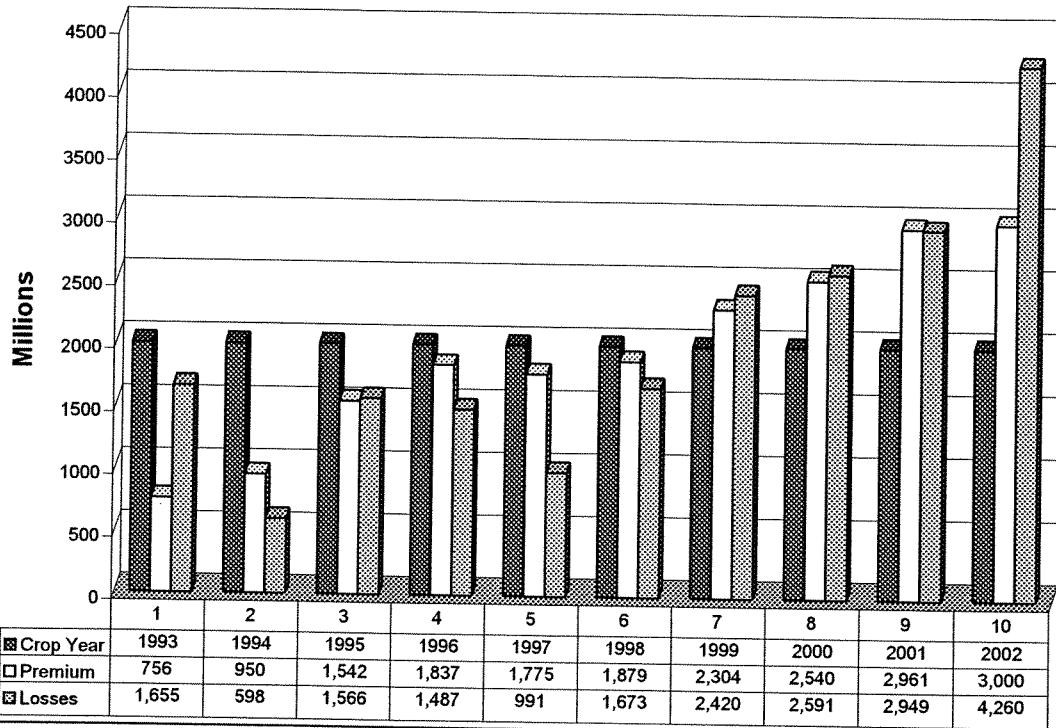


nationwide database to track producer participation in crop insurance programs, develop adequate production documentation, identify high-risk producers, assess the performance of insurance providers and other activities to improve the integrity and fiscal responsibility of the federal crop insurance program.

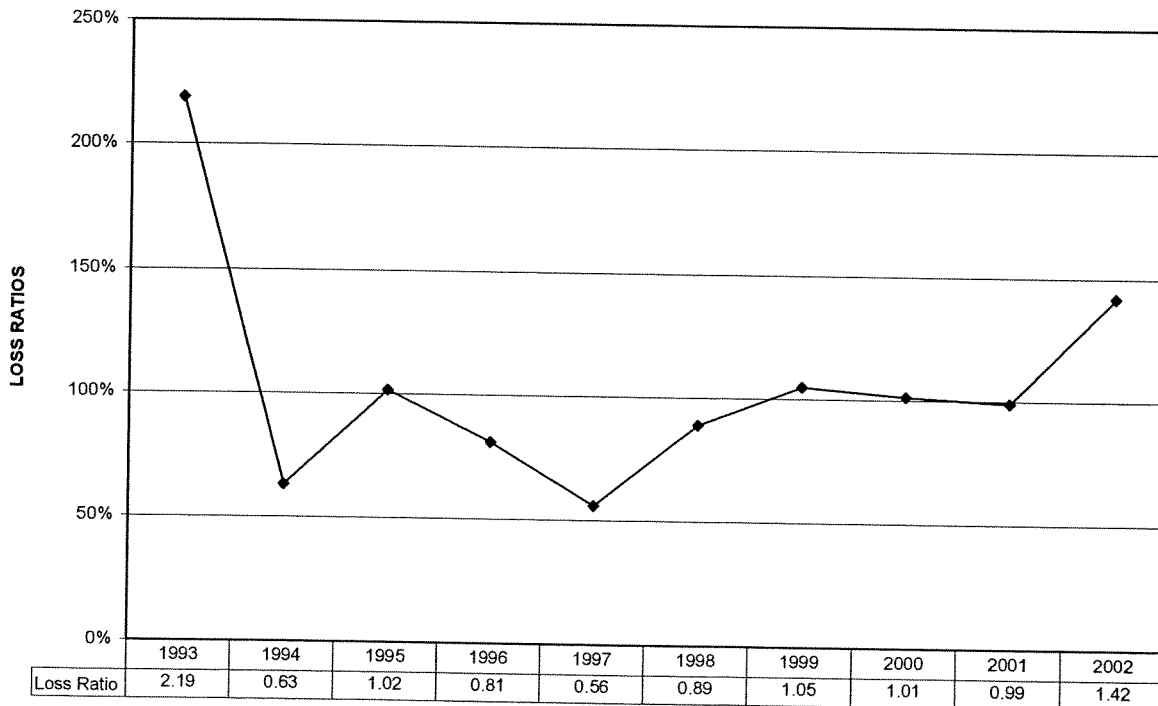
**Ineligible Tracking System**

The FCIC implemented the Ineligible Tracking System (ITS) in October 1997, for the 1998 crop year. The ITS identifies persons who have rendered themselves ineligible for crop insurance benefits as a result of a violation of crop insurance policy provisions. The FCIC will not reinsure a crop insurance policy for a person identified as ineligible.

### SUMMARY OF PREMIUMS AND LOSSES



### SUMMARY OF LOSS RATIOS



**RISK MANAGEMENT AGENCY  
FEDERAL CROP INSURANCE CORPORATION  
Consolidated Balance Sheets  
As of September 30, 2002 and 2001  
(in millions)**

	2002	2001
<b>ASSETS</b>		
Intragovernmental		
Fund Balance with Treasury	\$ 2,352	\$ 2,493
Accounts Receivable	1	4
Total Intragovernmental	2,353	2,497
Accounts Receivable	1,241	1,029
Advances	116	109
Total Assets	3,710	3,635
<b>LIABILITIES</b>		
Intragovernmental		
Accounts Payable	-	10
Other Liabilities	(1)	1
Total Intragovernmental Liabilities	(1)	11
Accounts Payable	93	119
Other Liabilities	346	653
Estimated Losses on Insurance Claims	2,874	1,899
Unearned Revenue	207	220
Total Liabilities	3,519	2,902
Commitments and Contingencies		
<b>NET POSITION</b>		
Unexpended Appropriations	331	432
Cumulative Results of Operations	(678)	(237)
Capital Stock	500	500
Paid-in Capital	38	38
Total Net Position	191	733
Total Liabilities and Net Position	\$ 3,710	\$ 3,635

See accompanying notes to consolidated financial statements.

**RISK MANAGEMENT AGENCY  
FEDERAL CROP INSURANCE CORPORATION  
CONSOLIDATED STATEMENTS OF NET COST  
For the Years Ended September 30, 2002 and 2001  
(in millions)**

	2002	2001
PROGRAM COSTS:		
Multi-Peril Crop Insurance Program Costs:		
Intragovernmental Gross Costs		
Other Program Costs	\$ 61	\$ 29
Intragovernmental Net Costs	61	29
Gross Costs With the Public		
Indemnities	3,894	3,408
Other:		
Program Delivery Costs	656	648
Other Program Costs	54	53
Total Costs with the Public	4,604	4,109
Premium Revenue	1,141	915
Other Revenue	58	61
Less: Earned Revenue with the Public	1,199	976
Net Costs With the Public	3,405	3,133
<b>Net Cost of Operations</b>	<b>\$ 3,466</b>	<b>\$ 3,162</b>

See accompanying notes to consolidated financial statements.

**RISK MANAGEMENT AGENCY  
FEDERAL CROP INSURANCE CORPORATION  
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION  
For the Years Ended September 30, 2002 and 2001  
(in millions)**

	2002				2001			
	<u>Cumulative Results of Operations</u>	<u>Capital Stock</u>	<u>Additional Paid-in Capital</u>	<u>Unexpended Appropriations</u>	<u>Cumulative Results of Operations</u>	<u>Capital Stock</u>	<u>Additional Paid-in Capital</u>	<u>Unexpended Appropriations</u>
Beginning Balances	\$ (237)	\$ 500	\$ 38	\$ 432	\$ (58)	\$ 500	\$ 38	\$ 36
<u>Budgetary Financing Sources:</u>								
Appropriations Received				2,896				3,472
Appropriations Transferred				(2)				(5)
Other Adjustments	-			20	-			(160)
Appropriations Used	3,015			(3,015)	2,911			(2,911)
<u>Other Financing Sources:</u>								
Transfers in (out) without Reimbursement	-				63			
Imputed Financing from Costs by Others	10				9			
Total Financing Sources	3,025	-	-	(101)	2,983	-	-	396
Net Cost of Operations	3,466				3,162			
Ending Balances	\$ (678)	\$ 500	\$ 38	\$ 331	\$ (237)	\$ 500	\$ 38	\$ 432

See accompanying notes to consolidated financial statements.

**RISK MANAGEMENT AGENCY  
FEDERAL CROP INSURANCE CORPORATION  
COMBINED STATEMENTS OF BUDGETARY RESOURCES  
For the Years Ended September 30, 2002 and 2001  
(in millions)**

	2002	2001
<b>Budgetary Resources:</b>		
Budget Authority:		
Appropriations Received	\$ 2,896	\$ 3,472
Net Transfers	(2)	(5)
Unobligated Balances		
Beginning of Period	1,234	409
Spending Authority from Offsetting Collections:		
Earned (Collected)	819	914
4. Recoveries of Prior Year Obligations	20	6
5. Temporarily not Available Pursuant to Public Law		
6. Permanently not Available	(4)	-
7. Total Budgetary Resources	4,963	4,796
<b>Status of Budgetary Resources:</b>		
Obligations Incurred		
Direct	3,936	3,562
Unobligated Balance		
Apportioned	718	907
Other Available	299	319
Unobligated Balance not Available	10	8
Total Status of Budgetary Resources	4,963	4,796
<b>Relationship of Obligations to Outlays:</b>		
Obligations Incurred	3,936	3,562
Less: Spending Authority from Offsetting Collections and recoveries of Prior Year Obligations	(839)	(920)
Obligated Balance, Net, Beginning of Period	1,264	1,150
<u>Obligated Balance, Net, End of Period</u>		
Undelivered Orders	(71)	(70)
Accounts Payable	(1,260)	(1,194)
	(1,331)	(1,264)
Total Outlays	3,030	2,528
<u>Outlays Detail:</u>		
Disbursements	3,849	3,442
Collections	(819)	(914)
Subtotal	3,030	2,528
Less Offsetting Receipts	-	-
Net Outlays	3,030	2,528

See accompanying notes to consolidated financial statements.

**FEDERAL CROP INSURANCE CORPORATION**  
**CONSOLIDATED STATEMENTS OF FINANCING**  
For the Years Ended September 30, 2002 and 2001  
(in millions )

**Resources Used to Finance Activities:**

Budgetary Resources Obligated

Obligations Incurred

2002	2001
\$ 3,936	\$ 3,562
839	920
3,097	2,642
10	9
10	9
3,107	2,651
1	36
1	36
3,106	2,615
212	(28)
148	575
360	547
3,466	3,162

Less: Spending Authority from Offsetting Collections and recoveries

Obligations net of offsetting collections and recoveries

Other Resources:

Imputed financing from costs absorbed by others

Net Other Resources Used to Finance Activities

Total Resources Used to Finance Activities

**Resources Used to Finance Items Not Part of the Net Cost of Operations:**

Changes in budgetary resources obligated for goods, services and benefits ordered but not yet provided

Total resources used to finance items not part of the cost of operations

Total resources used to finance the net cost of operations

**Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:**

Components Requiring or Generating Resources in Future Periods

Increase in exchange revenue receivable from the public

Other

Total components of Net Cost of Operations that will not require or generate resources in future periods

Net Cost of Operations

See accompanying notes to consolidated financial statements.

**RISK MANAGEMENT AGENCY  
FEDERAL CROP INSURANCE CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2002 and 2001**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

**Reporting Entity**

The Federal Crop Insurance Corporation (FCIC) is a wholly owned government corporation within the United States Department of Agriculture (USDA) and is not subject to federal, state, or local income taxes and, accordingly, no provision for income taxes is reported. These consolidated financial statements include the Risk Management Agency (RMA) and the FCIC; hereafter the combined entity will be referred to as the FCIC. The FCIC was established with the Federal Crop Insurance Act, which was enacted as Title V of the Agricultural Adjustment Act of 1938 (52 Statute 72). The FCIC manages a multiple-peril crop insurance (MPCI) program to assist in stabilizing and protecting the farming sector of the nation's economy. This 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 that was authorized by the Agriculture Act of 1949, as amended.

The RMA was established under provision of the Federal Agricultural Improvement and Reform Act of 1996 (the 1996 Act), Public Law 104-127, signed April 4, 1996. This act amended the Department of Agriculture Reorganization Act of 1994, P.L. 103-354, Title II, to require the Secretary to establish within the USDA, an independent office responsible for supervision of the FCIC, administration and oversight of programs authorized under the Federal Crop Insurance Act (7 U.S.C. 1501 *et seq.*), any pilot or other programs involving revenue insurance, risk management education, risk management savings accounts, or the use of the futures market to manage risk and support farm income that may be established under the Federal Crop Insurance Act or other law; and such other programs the Secretary considers appropriate.

On June 20, 2000 the President signed the Agricultural Risk Protection Act of 2000 into law effective starting with fiscal year 2001. Major provisions of this new legislation include: expanded use of contracts and partnerships for the research and development of policies and other risk management tools; prohibited research and development by the FCIC; revisions in CAT administrative fees and loss adjustment expense reimbursement; significant premium subsidy changes; livestock coverage authorization, reimbursement of research, development and maintenance costs for products submitted to the FCIC; expanded risk management education and assistance; provisions to address under-served areas, States, and commodities; establishment of an expert review panel and procedures for reviewing policies, plans of insurance, and related material or modifications; improved program compliance and integrity provisions; availability and acceptance of electronic information; good farming practices to include scientifically sound sustainable and organic farming practices; and others not included herein.



The objectives include the following items:

- Increase the number of economically sound risk management tools that are available and utilized by producers to meet their needs;
- Increase the agricultural community's awareness of risk management alternatives; and
- Improve program integrity and protect taxpayers' funds.

The Farm Security and Rural Investment Act of 2002 (2002 Farm Bill) was signed into law on May 13, 2002. Major provisions to this new legislation included: Authorization for sweet potato insurance to extend beyond the time the crop is in the field (as in the case of tobacco and potatoes), and expansion of the adjusted Gross Revenue Insurance pilot program into additional counties in California and Pennsylvania.

The FCIC has one delivery system in place to market the MPCCI program. The reinsurance business permits private insurance companies to write MPCCI that is reinsured by the FCIC. These companies were compensated by the FCIC for expenses associated with marketing and fully servicing (including claims adjustment, claims processing, billings, and premium collections) the MPCCI policies reinsured by the FCIC. The reinsurance business has been the FCIC's sole delivery system for the MPCCI since 1998. MPCCI is available for 77 different commodities (approximately 600 commodities as enumerated for disaster assistance purposes) in over 3,000 counties with policies covering all 50 states and Puerto Rico.

The FCIC is under the direction and control of a board of directors, which is appointed by the Secretary.

The FCIC receives all federal appropriations from the U.S. Department of Agriculture, budget classification (code 350).

### **Basis of Presentation and Accounting**

The accompanying consolidated financial statements have been prepared to report the balance sheet, net cost, changes in net position, budgetary resources, and financing of the FCIC. The consolidated financial statements have been prepared from the books and records of the FCIC in accordance with Generally Accepted Accounting Principles (GAAP). GAAP for Federal financial reporting entities recognizes the Federal Accounting Standards Advisory Board (FASAB) as the standard setting body. The financial statements are presented in accordance with the Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements*. All significant transactions and balances among FCIC's appropriations have been eliminated in consolidation. These consolidated financial statements are different from the financial reports, prepared by the FCIC pursuant to OMB directives, which are used to monitor and control the FCIC's use of budgetary resources.

The FCIC records accounting transactions on both an accrual and budgetary basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash.

Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. All inter-fund balances have been eliminated in the accompanying consolidated financial statements.

### **Use of Estimates**

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates made are in connection with the recognition of the losses on insurance claims liability.

### **Fair Value of Financial Instruments**

In the case of the FCIC's financial instruments, the carrying values approximate fair values because of their short-term maturity.

### **Revenue and Subsidy Recognition**

Premium revenue is comprised of producer paid premium and premium subsidy appropriated by the federal government. Producer paid premium is recognized as earned ratably over each crop's growing season and is stated net of the underwriting gains/losses, which will be returned to the reinsured companies. The portion of producer paid premium not recognized at the conclusion of the fiscal year is classified as unearned revenue, non-federal in the consolidated balance sheet. Premium subsidy is recognized as earned when expended. The unexpended premium subsidy remains an unexpended appropriation in the consolidated balance sheet.

The sum of producer paid premium and premium subsidy has been calculated using generally accepted actuarial methods to attain a break-even loss ratio of 100%. Premium subsidy is not considered written to the extent a portion remains unexpended and no unearned revenue is recorded in the consolidated balance sheet. As a result, the expected claim costs and claim adjustment expenses exceed the related unearned revenue. A premium deficiency is therefore recognized in the consolidated balance sheet by accruing a liability recorded as an other liability for the excess amount.

Insurance Fund appropriations, Administrative and Operation (A&O) Fund appropriations, and other financing sources are recognized when expended, which corresponds to when the expenses are incurred. The amount of appropriations not expended is a component of unexpended appropriations in the net position of the Balance Sheet.

In fiscal year 2002, the FCIC received appropriations for the Insurance Fund and the RMA received appropriations for the A&O Fund. The Insurance Fund appropriations are available until expended, while the A&O Fund appropriations are available to cover obligations incurred in a given fiscal year. These consolidated financial statements include all activity related to the Insurance Fund and A&O Fund appropriations.

### **Claims Recognition**

The liability for estimated losses on insurance claims represents those claims that have been incurred, but for the most part, have not been reported to the FCIC as of the Balance

Sheet date. Because of this, the estimation of these liabilities relies on calculations using historical experience adjusted for changes in crop growing conditions. Also, because of the significant uncertainties associated with the assumptions used, the ultimate liabilities may differ significantly from the recorded estimates.

Administrative expenses associated with claims adjusters and reinsured companies are paid through the FCIC's Insurance Fund. Indemnity costs are paid from premium proceeds, including premium subsidies and premium discounts, which are also a part of the FCIC's Insurance Fund.

The estimated aggregate loss ratio including the premium subsidy appropriation for 2002 crop year was approximately 142% (\$1.42 of claims for every \$1.00 of premium and premium subsidy) and the actual aggregate loss ratio for 2001 crop year was approximately 99% (\$0.99 for every \$1.00 of premium and premium subsidy). In the 2002 and 2001 fiscal years, federal premium subsidy and Emergency Financial Assistance premium discounts funded approximately 60% of the total premium with approximately 40% being paid by the producer.

### **Reinsurance Administrative Expenses and Payables**

The FCIC includes reinsurance administrative expenses as program costs because they vary with, and are directly related to, acquiring new and carry-over business. Due to loss ratios at or in excess of 100% of producer premium without regard to the premium subsidy appropriation, all reinsurance administrative expenses have been expensed in the period in which they were incurred.

Section 508 (k) of the 1994 Act authorizes the FCIC to enter into reinsurance agreements with private insurance companies. Under these agreements, the FCIC assumes the majority of the risk of loss on MPCCI written by the reinsured companies.

The 1998 SRA was renewed through the 2002 reinsurance year, and provided for both proportional and nonproportional means by which the risk of loss may be ceded to the FCIC. The reinsured companies elect the method to transfer risk to the FCIC through their plan of operation. The plan of operation becomes a part of the SRA for each reinsurance year (July 1 through June 30).

Proportional reinsurance provides for a one-to-one percentage exchange of losses and premiums between the reinsured company and the FCIC. A reinsured company may not cede to the FCIC, under proportional methods, premiums that exceed 65% of its total book of business for the 2001 and 2000 reinsurance contracts. The FCIC uses nonproportional reinsurance programs which limit losses in the reinsured's retained book of business after the cessions made under proportional methods. Stop loss reinsurance is applied by state, by fund, if necessary, based upon the ratio of the reinsured's ultimate net losses to its retained net book premium.

The SRA provides for reimbursement to the reinsured companies for administrative expenses, including loss adjustment expenses. The SRA's reimbursement rates (as a percent of premium) are as follows for the 2002 and 2001 reinsurance years: Group Risk Plans (GRP), 22.7%; revenue plans that could increase liability at harvest, 21.1%; and all

other plans, 24.5%. Reinsured companies were also allowed an expense reimbursement for adjusting catastrophic claims of 8% for the 2002 and 2001 reinsurance years.

### **Fund Balance with Treasury**

Fund Balance with Treasury represents the aggregate amount of funds in the FCIC's accounts with Treasury for which the FCIC is authorized to make expenditures and pay liabilities. The FCIC's Fund Balance with Treasury consists of appropriated funds and receipts collected from non-federal entities.

### **Property and Equipment**

Property and equipment consists of office furniture, computer equipment, and computer software. Property and equipment with an acquisition cost of \$5,000 or more and an estimated useful life of at least two years are capitalized. Property and equipment with an acquisition cost of less than \$5,000 is expensed when purchased. Property and equipment is depreciated using the straight-line method over useful lives that range from 6 to 10 years. There are no restrictions on the use or convertibility of the FCIC's property and equipment.

### **Retirement Plans**

Most employees hired after December 31, 1983 are covered by the Federal Employees Retirement System (FERS). FERS is a three-tiered retirement plan consisting of Social Security benefits, a basic plan benefit, and a thrift savings plan (TSP). The FCIC and the employee each contribute 6.2% of the employee's basic pay through payroll taxes for Social Security benefits. Under the FERS basic benefit plan, the employee contributes .8% of basic pay and the FCIC contributes 10.7% of basic pay for FERS employees. The cost of providing the FERS basic benefit is equal to the amounts contributed by the FCIC and the employees because the plan is fully funded.

A TSP account is automatically established for employees covered by FERS, and the FCIC makes a mandatory contribution of 1% of basic pay to this account. Employees are eligible to contribute up to 12% (11% in fiscal year 2001) of basic pay to their TSP account subject to a maximum overall yearly contribution of \$11,000 (\$10,500 in calendar year 2001). The FCIC makes matching contributions, ranging from 1% to 4%, for employees who contribute to their TSP accounts.

Most employees hired on or before December 31, 1983, participate in the Civil Service Retirement System (CSRS), CSRS is a single benefit retirement plan. The FCIC and the employee each contribute 7% of the employee's basic pay. Employees covered under CSRS are eligible to contribute up to 7% of basic pay to a TSP account to a maximum overall yearly contribution of \$11,000 (\$10,500 in calendar year 2001). The FCIC makes no matching contributions to TSP accounts established by employees covered under CSRS.

The limits will continue to increase by one percentage point per year through fiscal year 2005, after which all participants will be eligible to contribute up to the Internal Revenue Code's annual deferral limit (\$11,000 in calendar year 2002).

The FCIC does not report FERS or CSRS assets, accumulated plan benefits, or unfunded liabilities on its consolidated financial statements. Reporting such amounts is the responsibility of the Office of Personnel Management (OPM).

SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, requires Federal entities to recognize an expense for pensions and other retirement benefits at the time the employee's services are rendered. The purpose of recognizing this expense is to record and report the full cost of each entity's operation. A corresponding revenue, Imputed Financing Sources, is recognized to the extent pension and other retirement benefit expenses exceed the amount paid to the OPM.

### Net Position

Net position is the residual difference between assets and liabilities and is composed of capital stock, additional paid-in capital, unexpended appropriations, and cumulative results of operations. Unexpended appropriations represent the amount of unobligated and unexpended budget authority. Unobligated balances are the amount of appropriations or other authority remaining after deducting the cumulative obligations from the amount available for obligation and undelivered orders. Cumulative results of operations are the net result of the FCIC's operations since inception.

### Reclassifications

Certain reclassifications were made to prior year amounts to conform to the current year presentation.

## 2. FUND BALANCE WITH U.S. TREASURY:

	<u>2002</u> (in millions)		
	<u>Appropriated</u> <u>Funds</u>	<u>Revolving</u> <u>Funds</u>	<u>Total</u>
Obligated	\$ 21	1,305	1,326
Unobligated available	1	1,017	1,018
Unobligated unavailable	8	-	8
<b>Total</b>	<b>\$ 30</b>	<b>2,322</b>	<b>2,352</b>

	<u>2001</u> (in millions)		
	<u>Appropriated</u> <u>Funds</u>	<u>Revolving</u> <u>Funds</u>	<u>Total</u>
Obligated	\$ 34	1,933	1,967
Unobligated available	1	517	518
Unobligated unavailable	8	-	8
<b>Total</b>	<b>\$ 43</b>	<b>2,450</b>	<b>2,493</b>

The FCIC maintains separate accounts for the A&O (appropriated) and Insurance (revolving) Funds. The A&O Fund is used to pay administrative and operating expenses. The Insurance Fund is used to pay losses, and can also be used to pay claim adjustment expenses, reinsured company expenses, and costs referenced in the Agricultural Risk

Protection Act. The FCIC does not earn interest on funds maintained in U.S. Treasury accounts. All funds are currently available to the FCIC except for the unobligated appropriated (i.e., A&O) funds that were only available for obligations through September 30, 2002.

### 3. ADVANCES:

Advances consist of the following:

	2002	2001
	(in millions)	
Advances to reinsured companies for escrow losses	\$ 114	108
Advances to reinsured companies for state premium subsidy	2	1
<b>Total advances</b>	<b>\$ 116</b>	<b>109</b>

The FCIC's advances to reinsured companies represent amounts funded to escrow accounts for which the companies' loss checks issued have not yet cleared.

### 4. ACCOUNTS RECEIVABLE:

Accounts receivable, net, federal and non-federal is as follows:

<b>2002</b> (in millions)	Gross Accounts <u>Receivable</u>	<u>Allowance for</u> <u>Uncollectible</u> <u>Accounts</u>	Net Accounts <u>Receivable</u>
Intragovernmental	\$ 1	0	1
With the Public	1,246	5	1,241
<b>Total</b>	<b>\$ 1,247</b>	<b>5</b>	<b>1,242</b>

<b>2001</b> (in millions)	Gross Accounts <u>Receivable</u>	<u>Allowance for</u> <u>Uncollectible</u> <u>Accounts</u>	Net Accounts <u>Receivable</u>
Intragovernmental	\$ 4	0	4
With the Public	1,034	5	1,029
<b>Total</b>	<b>\$ 1,038</b>	<b>5</b>	<b>1,033</b>

Accounts receivable with the public represent premiums from reinsured companies due to the FCIC for crop insurance written by the reinsured companies and reinsured by the FCIC. The reinsured companies are responsible for collecting the premium from the producer and paying the FCIC, whether or not the premium has been collected from the producer. Reinsured companies are also responsible for a portion of the underwriting losses.

Producers' accounts receivable represent amounts due from individual producers for interest, overpaid indemnities, and premiums which are payable directly to the FCIC. It also includes estimated buy-up and catastrophic fees turned over by reinsured companies to the FCIC for collection. The FCIC provides an allowance for uncollectible accounts based upon historical experience.

The FY 2002 allowance for uncollectible accounts also represents approximately \$4.8 million for reinsurance recoverables and \$0.2 million for uncollectible CAT and additional coverage fees in the fiscal year.

## 5. ACCOUNTS PAYABLE:

Accounts payable, non-federal, is as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Reinsured companies	\$ 93	109
Administrative and other	0	10
<b>Total accounts payable, non-federal</b>	<b>\$ 93</b>	<b>119</b>

Accounts payable to reinsured companies represent the reimbursement to the reinsured companies for administrative expenses, including claim adjustment expenses, as provided by the SRA.

## 6. UNEARNED REVENUE:

Unearned revenue is as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Unearned producer premium	\$ 207	220
<b>Total unearned premium</b>	<b>\$ 207</b>	<b>220</b>

**7. OTHER LIABILITIES:**

Other liabilities covered by budgetary resources, federal and non-federal, are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Federal		
DOPP advance from CCC	\$ 1	-
Other accrued liabilities	(2)	1
Total other liabilities, federal subtotal	\$ (1)	1
Non-Federal:		
Underwriting gain payable to reinsured companies (includes reserves)	38	324
Reserve for premium deficiency	\$ 299	319
Federal Employees Compensation Act Liability	4	5
Annual leave liability	4	3
Other accrued liabilities	1	2
Total other liabilities, non-federal subtotal	\$ 346	653
Total other liabilities	\$ 345	654

The Dairy Options Pilot Program (DOPP) is a pilot program to determine whether futures and options can provide a meaningful reduction in market risk faced by milk producers. The program that is administered by the FCIC is funded by the CCC funds that were advanced to the FCIC. The unobligated portion of DOPP funds is reflected as a liability because the funds will be returned to CCC, if unused.

Premiums and losses are reported monthly under the SRA and a periodic settlement, as stipulated in the agreement 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 while the reinsured companies pay underwriting losses to the FCIC. However, a portion of the underwriting gain payable includes amounts being held in reserve from prior years for any future underwriting losses incurred by the reinsured companies.

Included in other liabilities are liabilities that are not covered by budgetary resources that amount to approximately \$7.4 million and \$8.2 million for accrued annual leave and Federal Employees Compensation Act (FECA) liabilities at September 30, 2002 and 2001, respectively. Liabilities not covered by budgetary resources are not funded by current appropriations from Congress. Annual leave is accrued as it is earned and the accrual is reduced as it is taken. As of September 30, 2002 and 2001, the balance in the accrued annual leave account was adjusted to reflect current pay rates and annual leave balances.



A premium deficiency has been recorded as the expected claim costs and claim adjustment expenses exceed the related unearned revenue. See also Revenue and Subsidy Recognition footnote for further disclosure.

## 8. NET POSITION:

Net position is as follows:

<b>2002</b> (in millions)	Revolving Funds	Appropriated Funds	Total
Capital stock	\$ 500	-	500
Additional paid-in capital	38	-	38
Unexpended Appropriations:			
Unliquidated obligations	-	22	22
Unobligated, not available	-	8	8
Unobligated, available	300	1	301
Subtotal, unexpended Appropriations	300	31	331
Cumulative Results of Operations:			
Donated capital	3,958	-	3,958
Results of operations	(4,629)	(7)	(4,636)
Subtotal, cumulative results of operations	(671)	(7)	(678)
Total net position	\$ 167	24	191

<b>2001</b> (in millions)	Revolving Funds	Appropriated Funds	Total
Capital stock	\$ 500	-	500
Additional paid-in capital	38	-	38
Unexpended Appropriations:			
Unliquidated obligations	-	29	29
Unobligated, not available	-	8	8
Unobligated, available	394	1	395
Subtotal, unexpended Appropriations	394	38	432
Cumulative Results of Operations:			
Donated Capital	3,958	-	3,958
Results of operations	(4,187)	(9)	(4,196)
Subtotal cumulative results of operations	(228)	(9)	(237)
Total net position	\$ 704	29	733

### Donated Capital:

Prior to the 1994 Act, the Secretary was authorized to use the funds of the CCC, to pay claims of the FCIC if the funds available to the FCIC for that purpose were insufficient. The 1994 Act eliminated the need for the FCIC to request funds from the CCC. Although the authority to use the CCC funds still exists, the FCIC is now authorized to draw necessary funds directly from the U.S. Treasury (with USDA and OMB approval) to cover operating expenses including excess losses.

### Capital Stock:

Section 504 (a) of the 1994 Act directs authorizes capital stock of \$500 million subscribed by the United States. There has been no change in the capital stock issued since August 15, 1985.

## 9. INDEMNITY COSTS AND NET INSURANCE PREMIUM REVENUES:

Insurance indemnity costs are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Catastrophic coverage	\$ 28	80
Additional coverage	3,866	3,325
Outside litigation	0	3
<b>Insurance claims and indemnities</b>	<b>\$ 3,894</b>	<b>3,408</b>

Net insurance premium revenues are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Producer premium income	\$ 1,216	1,189
Underwriting gain due reinsured companies	(75)	(274)
<b>Net insurance premium revenues</b>	<b>\$ 1,141</b>	<b>915</b>

## 10. PROGRAM DELIVERY AND OTHER PROGRAM COSTS:

Program delivery costs are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Reinsurance administrative expenses	\$ 656	648
Total non-federal program delivery costs	\$ 656	648

Federal other program costs are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Reimbursable costs	\$ 46	15
Other retirement benefit, other post-employment benefit, FECA, and other costs	5	5
Imputed costs	10	9
Total federal other program costs	\$ 61	29

Non-federal program costs are as follows:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Other program costs	\$ 16	9
Administrative and other cost	38	44
Total non-federal other program costs	\$ 54	53

## 11. FINANCING SOURCES:

In fiscal years 2002 and 2001, the FCIC received an Insurance Fund appropriation of \$2.8 billion and \$3.5 billion respectively, for premium subsidy, reinsurance administrative expenses and other program expenses and for research and development. In fiscal years 2002 and 2001, the RMA A&O Fund appropriation was \$75.3 million and \$65.7 million respectively.

The following table summarizes appropriations used:

	<u>2002</u>	<u>2001</u>
	(in millions)	
Net A&O appropriation used	\$ 82	64
Appropriation for premium subsidy	1,827	1,325
Appropriation for ARPA costs	31	9
Appropriation for delivery costs	656	648
Appropriation for excess losses	415	865
Appropriation for EFA discount	4	0
Insurance fund appropriations, subtotal	2,933	2,847
Total appropriations used	\$ 3,015	2,911

Provisions of ARPA place a major emphasis on contracting and partnering for development of risk management products. ARPA provides incentives for private parties to develop and submit new risk management products to the FCIC Board of Directors. In fiscal year 2001, \$67.5 million (\$5 million was transferred to Cooperative State Research, Education, and Extension Service, CSREES) was appropriated for ARPA expenses with \$8.4 million included as other program costs on the Statement of Net Cost. The unexpended balance for ARPA was approximately \$54.1 million as of September 30, 2001. In fiscal year 2002, \$52 million was appropriated for ARPA expenses with \$2 million being transferred to CSREES. The unexpended balance for ARPA was approximately \$54.6 million as of September 30, 2002.

## 12. ESTIMATED LOSSES ON INSURANCE CLAIMS:

The following table summarizes the activity in the accrual for estimated losses on insurance claims.

	<u>2002</u>	<u>2001</u>
	(in millions)	
Balance as of October 1	\$ 1,899	1,314
Incurred Related to:		
Current year	3,564	2,653
Prior year	330	755
Total Incurred	3,894	3,408
Less Paid Related to:		
Current year	(1,947)	(1,434)
Prior year	(972)	(1,389)
Total Paid	(2,919)	(2,823)
Net balance as of September 30	\$ 2,874	1,899

The FCIC experienced adverse loss development related to the prior crop years in fiscal year 2002 and fiscal year 2001. As a result incurred claims related to prior years increased approximately \$330 million fiscal year 2002 and \$755 million fiscal year 2001.

The FCIC is a defendant in various litigation cases arising in the normal course of business. Management has recorded a liability in the accompanying consolidated financial statements for the estimated settlement amounts of these cases. This \$3 million liability is based upon management's best estimate at the time of financial statement preparation. Furthermore, in order to defend its policies and procedures, the FCIC may, in some instances, pay litigation expenses and judgments over and above indemnities found under the SRA for reinsured companies. For this reason, the FCIC is consulted with and approves significant decisions in the litigation process. In addition, in 2001 fiscal year, a \$3 million liability was recorded for class action suits filed in the United States District of Minnesota on behalf of sugar beet producers after reinsured companies refused to pay indemnities where damages were discovered after delivery and piling.

### **13. STATEMENT OF BUDGETARY RESOURCES:**

FCIC's Statement of Budgetary Resources serves as a tool to link budget execution data to information reported in the "actual" column of the Program and Financing Schedules in the Appendix of the Budget of the United States Government (referred to as the "President's Budget") as well as information reported in the Reports of Budget Execution and Budgetary Resources (SF-133). Some reporting differences do exist between comparable amounts in the Statement of Budgetary Resources, the President's Budget, and the SF-133. On an aggregate level, these differences amount to less than one-tenth of one percent of FCIC's total budgetary resources and are therefore considered immaterial. The differences are not due to error or omission; rather, the differences arise from timing, varying OMB reporting requirements, and current and prior year audit adjustments.

#### 14. CHANGE IN ACCOUNTING POLICY FOR APPROPRIATIONS:

In fiscal year 2002, FCIC changed its accounting policy for recognizing appropriations as expended. Accordingly, the consolidated financial statements of all prior periods are restated. FCIC previously reported appropriations as expended when the liabilities were thought to be incurred, which corresponded to when the risk was underwritten. FCIC has now determined that the liabilities are incurred and the appropriation expended at the point in time the appropriation is used to subsidize a paid indemnity.

The effect of this change in policy on the accompanying consolidated financial statements was:

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	New Method	Old Method	Difference
<b>Consolidated Balance Sheet:</b>			
Other Liabilities	653	334	319
Intergovernmental Unearned Revenue	0	319	(319)
<b>Consolidated Statement of Changes in Net Position:</b>			
Cumulative Results of Operations	(237)	82	319
Unexpended Appropriations:	432	114	(319)
<b>Combined Statement of Budgetary Resources:</b>			
Unobligated Balance BOP	409	291	118
Obligations Incurred	3,562	4,152	(590)
Unobligated Balance Available	1,227	517	710
Obligated Balance EOP	1,264	1,964	700
<b>Consolidated Statement of Financing:</b>			
Obligations Incurred	3,562	4,152	(590)
<b>Total components of Net Cost of Operations that will not require or or generate resources during the reporting period</b>			
	547	(43)	590

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#### 15. SUBSEQUENT EVENTS:

Subsequent to the end of fiscal year 2002, one of the reinsured companies, American Growers Insurance Company (AGIC), was placed under an order of supervision by the Nebraska Department of Insurance. On December 10, 2002, the FCIC signed a Memorandum of Understanding (MOU) with the Nebraska Department of Insurance that establishes the responsibilities and understandings between the FCIC and the Nebraska Department of Insurance with respect to AGIC. The FCIC is working with the Nebraska Department of Insurance and AGIC management to ensure that all outstanding policy claims will be paid and service to producers for 2002 crop year will continue.

The MOU establishes the framework to ensure that AGIC personnel, loss adjustors, and agents continue servicing policyholders. To achieve these goals, key employees at AGIC will be retained to finish servicing of the 2002 crop year book of business. In addition, expenses related to loss adjustment, billing, and agents commissions associated with policies reinsured by the FCIC will be paid to ensure the timely payment of crop insurance claims, adequate levels of service going forward, and the timely collection and transmission of premiums to the FCIC. Further, maintaining a viable agent network is essential to making sure that policyholders are quickly transferred to other crop insurance companies for 2003 and subsequent crop years.

AGIC had approximately \$580 million of the estimated \$3 billion 2002 crop year FCIC or 19% of FCIC's total book of business. Additional costs may be incurred by FCIC for other administrative costs of AGIC, however these costs are not quantifiable at this time.

## SUPPLEMENTARY STEWARDSHIP INFORMATION (UNAUDITED): Schedule 1

In response to the Secretary's 1996 Risk Management Education (RME) initiative, and as mandated by the 1996 Act, the FCIC has formed new partnerships with the Cooperative State Research, Education, and Extension Service (CSREES), the Commodity Futures Trading Commission, the USDA National Office of Outreach, Economic Research Service, and private industry to leverage the federal government's funding of its RME program by using both public and private organizations to help educate their members in agricultural risk management. The RME effort was launched in 1997 with a Risk Management Education Summit that raised awareness of the tools and resources needed by farmers and ranchers to manage their risks. RMA has built on this foundation during fiscal year 2002 by expanding State and Regional education partnerships; encouraging the development of information and technology decision aids; supporting the National Future Farmers of America (FFA) foundation with an annual essay contest; facilitating local training workshops; and supporting Cooperative Agreements with Educational and outreach organizations.

During fiscal year 2002, the RME worked toward the goals by funding approximately 1,200 risk management sessions compared to approximately 1,500 risk management sessions during fiscal year 2001. Most of these activities targeted producers directly. The number of producers reached through these sessions nearly 50,000 in fiscal year 2002 and 50,000 in fiscal year 2001. In addition to reaching producers, some training sessions helped those who work with producers, such as lenders, agricultural educators, and crop insurance agents, better understand those areas of risk management with which they may be unfamiliar. Total RME obligations incurred by the FCIC were approximately \$4.9 million for fiscal year 2002 and \$4.9 million for fiscal year 2001. The following table summarizes the RME initiatives since fiscal year 1998.

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(dollars in millions)				
RME Obligations	\$ 6	5	1	1	5
Number of producers attending RME sessions	<u>50,000</u>	<u>50,000</u>	30,000	14,500	N/A
Number of RME sessions held	<u>1,200</u>	<u>1,500</u>	1,200	950	N/A

One of the directives of ARPA is to step up the FCIC's educational and outreach efforts in certain areas of the country that have been historically underserved by the Federal crop insurance program. The Secretary determined that fifteen states met the underserved criteria. These states are Maine, Massachusetts, Connecticut, Wyoming, New Jersey, New York, Delaware, Nevada, Pennsylvania, Vermont, Maryland, Utah, Rhode Island, New Hampshire, and West Virginia.

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**REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED):**  
**Schedule 2**

Intra-governmental balances:

FCIC reports the following amounts as intra-governmental assets and liabilities, which are included in the September 30, 2002 and 2001 consolidated balance sheet:

Intra-governmental assets:

2002  
(in millions)

<u>Agency</u>	<u>Fund Balance with Treasury</u>	<u>Accounts Receivable</u>
Department of the Treasury	\$ 2,352	-
Other Federal Agencies	-	1
<b>Total intra-governmental assets</b>	<b>\$ 2,352</b>	<b>1</b>

2001  
(in millions)

<u>Agency</u>	<u>Fund Balance with Treasury</u>	<u>Accounts Receivable</u>
Department of the Treasury	\$ 2,493	-
Department of Agriculture	-	1
Other Federal Agencies	-	3
<b>Total intra-governmental assets</b>	<b>\$ 2,493</b>	<b>4</b>

Intra-governmental liabilities:

2002  
(in millions)

<u>Agency</u>	<u>Accounts Payable</u>	<u>Other Liabilities</u>
Department of Agriculture	\$	2
Other Federal Agencies	0	(3)
<b>Total intra-governmental liabilities</b>	<b>\$ 0</b>	<b>(1)</b>

(continued)

2001  
(in millions)

<u>Agency</u>	<u>Accounts Payable</u>	<u>Other Liabilities</u>
Department of Labor (Not covered by budgetary resources)	\$ -	1
Department of Agriculture	6	-
Other Federal Agencies	4	0
<b>Total intra-governmental liabilities</b>	<b>\$ 10</b>	<b>1</b>

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