

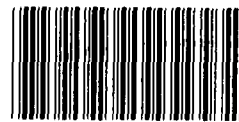
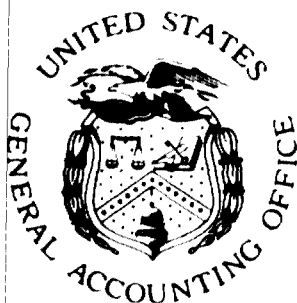
REPORT BY THE U.S. **RELEASED**

# General Accounting Office

## Followup On Actions Needed To Protect Depositors At Federally Examined Grain Warehouses

The Department of Agriculture administers the Federal licensing and examination program for agriculture commodity warehouses. The program is intended to ensure that producers have safe storage facilities.

In a June 1981 report GAO made several recommendations for actions the Department needed to take to ensure that warehouses have enough grain of the proper quality to meet all storage obligations and that they are financially sound. This report provides information on the actions the Department has taken in response to those recommendations.



121988

GAO/RCED-83-159

JULY 18, 1983

526192

**Request for copies of GAO reports should be sent to:**

**U.S. General Accounting Office  
Document Handling and Information  
Services Facility  
P.O. Box 6015  
Gaithersburg, Md. 20760**

**Telephone (202) 275-6241**

**The first five copies of individual reports are free of charge. Additional copies of bound audit reports are \$3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are \$1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".**



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,  
AND ECONOMIC DEVELOPMENT  
DIVISION

B-202986

The Honorable Thomas F. Eagleton  
Ranking Minority Member  
Subcommittee on Agriculture, Rural  
Development, and Related Agencies  
Committee on Appropriations  
United States Senate

Dear Senator Eagleton:

As requested in your April 28, 1982, letter, this report provides information on the actions the Department of Agriculture has taken in response to recommendations contained in our June 19, 1981, report entitled "More Can Be Done To Protect Depositors at Federally Examined Grain Warehouses" (GAO/CED-81-112).

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from its issue date. At that time we will send copies to the Director, Office of Management and Budget; the Secretary of Agriculture; various Senate and House committees; Members of Congress; and other interested parties. We will also make copies available to others on request.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "J. Dexter Peach".

J. Dexter Peach  
Director



D I G E S T

The Department of Agriculture administers a voluntary licensing and examination program for warehouses storing agricultural commodities under the U.S. Warehouse Act. The Department's Agricultural Marketing Service (AMS) administers the program to ensure that producers and the Federal Government have safe storage facilities. It also sets requirements for and examines warehouses storing commodities owned by the Commodity Credit Corporation (CCC) or pledged to CCC as loan collateral.

On June 19, 1981, GAO issued a report entitled "More Can Be Done To Protect Depositors at Federally Examined Grain Warehouses" (GAO/CED-81-112) which recommended that the Secretary of Agriculture make changes to the Department of Agriculture's warehouse examination and financial data review procedures to provide increased protection to depositors at grain warehouses. The report estimated that as many as 300 of the 6,400 warehouses then subject to Federal examination may have been financially unsound.

The Ranking Minority Member, Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations, asked GAO to provide updated information on (1) actions taken by Agriculture to implement GAO's recommendations, (2) the impact of the fiscal year 1983 budget on the Department's ability to improve its inspection activities, and (3) the extent of financial problems in the grain warehouse industry.

ACTIONS TAKEN ON PREVIOUS  
GAO RECOMMENDATIONS

GAO's 1981 report found that the development and use of a reliable formula for predicting warehouses that may go bankrupt in the foreseeable future would make the Federal warehouse examination program more effective. Accordingly, GAO recommended to the Secretary of Agriculture that appropriate action be taken.

As a result, the Department is in the process of developing a predictive formula to help identify grain warehouses in danger of bankruptcy, as GAO recommended.

In response to GAO recommendations calling for stricter financial reporting requirements, AMS and CCC amended their regulations effective July 1, 1982. AMS regulations now require that financial statements be prepared in accordance with generally accepted accounting principles and that they be audited by an independent certified public accountant. AMS regulations also provide that financial statements may be audited or reviewed by independent public accountants but will be accepted with the understanding that the warehouse will be subject to an onsite examination and audit by the Secretary.

In contrast, CCC regulations provide that financial statements may be accompanied by either a report of audit or review conducted by an independent certified public accountant or by an independent public accountant or with a compilation report.<sup>1</sup> CCC procedures provide that financial statements not audited by a certified public accountant may be subject to an examination by the Secretary. (See p. 8.)

GAO believes that because review reports and compilation reports do not contain an accountant's opinion, the reports do not provide the Department with sufficiently reliable financial information on warehouses. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Further, in a compilation report, the accountant does not express any opinion on the financial statements. An audit, on the other hand, is a critical examination of the accounting records by a public accountant. Through an evaluation of the company's system of internal controls, inspection of documents, observation of assets,

---

<sup>1</sup>A compilation report is management's representation of the financial statement. No auditing or reviewing has been done and, accordingly, no opinion or any other form of assurance is given.

and other accounting procedures, the accountant will gather evidence necessary to express an opinion on the fairness of the company's financial statements.

Financial statements audited by independent certified public accountants or independent public accountants, although more costly, would provide the Department and depositors at federally examined grain warehouses with greater assurance that the warehouses' financial statements are reliable. The audited statements would provide depositors with a better indication as to the warehouses' financial condition. (See p. 9.)

#### RECOMMENDATION TO THE SECRETARY OF AGRICULTURE

Although the Department has amended its warehouse financial reporting regulations since the June 1981 report, GAO recommends that the Department revise its regulations to require that federally examined warehouses submit annual financial statements accompanied by an audit report prepared by an independent certified public accountant or independent public accountant. (See p. 10.)

#### EXTENT OF FINANCIAL PROBLEMS AT GRAIN WAREHOUSES

GAO concluded that the industry's financial problems have not lessened. For example, the number of warehouses that have filed for bankruptcy or liquidated increased from 14 in 1980 to 23 in 1982. Further, of the 19 warehouses identified in GAO's June 1981 report that met GAO's criteria for being in financial trouble, only 8 were still in operation under the same owner. (See p. 13.)

#### IMPACT OF FISCAL YEAR 1983 BUDGET ON INSPECTION ACTIVITIES

The Department has reduced the number of examination hours expended and the frequency rate of warehouse examinations. However, Department officials stated that the funds available in the fiscal year 1983 budget was not a factor in its reduction decision because warehouses would be responsible for all or part of the examination cost. (See p. 18.)

Department officials also stated that the July 1, 1982, changes to the financial reporting requirements would provide them with additional financial information on warehouses. They believe that the additional information would make it possible to reduce the frequency of examinations needed to determine warehouses' financial condition.

GAO believes that the reduction in the frequency of warehouse examinations was premature considering the current financial condition of the grain warehouse industry and the lack of a predictive formula to be used for establishing priorities and frequencies of examinations. GAO also believes that any reductions in the frequency of warehouse examinations should not have been made until its recommendations regarding financial reporting requirements and the development of a predictive formula have been implemented and an improved financial condition demonstrated. Until then, the reduction in the frequency of examinations increases the possibility that some warehouses which are short of grain or are in financial difficulty will go undetected, increasing the likelihood of bankruptcy or liquidation.

#### AGENCY COMMENTS AND GAO EVALUATION

GAO obtained comments from the Department of Agriculture which generally agreed with the report's factual content. From an accounting viewpoint, the Department agreed with GAO's evaluation that financial statements accompanied by an audit report prepared by an independent certified public accountant or by an independent public accountant would provide the most reliable indication of a warehouse's financial condition. However, from an operations viewpoint, the Department believes that the financial information contained in compilation reports provides CCC with adequate assurance as to the solvency of warehouses.

GAO believes that compilation reports do not provide sufficiently reliable financial information because they do not contain an opinion by an accountant on the financial condition of the warehouse. GAO believes that annual financial statements, accompanied by an audit report prepared by an independent certified public accountant or independent public accountant, containing an accountant's opinion of



the financial statements, provide a more reliable indication of a warehouse's financial condition.

Tear Sheet



C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Description of the Federal warehouse examination program	1
	Statement of the problem	3
	Objectives, scope, and methodology	3
2	USDA ACTIONS ON RECOMMENDATIONS MADE IN OUR PRIOR REPORT	5
	Development and use of a predictive formula	5
	Financial data submitted by warehouses has improved	6
	USDA has improved its procedures for examining warehouses	7
	Steps taken to improve the reliability of warehouses' financial data	8
	Recommendation to the Secretary of Agriculture	10
	Agency comments and our evaluation	10
3	UPDATED INFORMATION ON THE EXTENT OF THE GRAIN WAREHOUSE INDUSTRY'S FINANCIAL PROBLEMS	12
	USDA and industry views	12
	UGSA warehouses that have filed for bankruptcy or liquidated	13
	Update on warehouses identified in our prior report as being in financial trouble	13
	Cases involving suspected or reported CCC contract violations	14
	Requests for OIG investigations	15
4	IMPACT OF USDA FISCAL YEAR 1983 BUDGET ON USDA'S ABILITY TO IMPROVE ITS INSPECTION ACTIVITIES	17
	Funding of USDA's warehouse examination program	17
	Reduction in USDA warehouse examination program activity	18

## ABBREVIATIONS

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
CPA	Certified Public Accountant
GAO	General Accounting Office
KCCO	Kansas City Commodity Office
OIG	Office of Inspector General
OMB	Office of Management and Budget
UGSA	uniform grain storage agreement
USDA	U.S. Department of Agriculture

## CHAPTER 1

### INTRODUCTION

#### DESCRIPTION OF THE FEDERAL WAREHOUSE EXAMINATION PROGRAM

Many producers and owners of agricultural products rely on warehouses to store their agricultural commodities. The basic concerns of depositors are that (1) warehouses provide a safe place for storing agricultural commodities, (2) the product be taken care of during storage, (3) the product be available for delivery when needed, and (4) the warehouse does not become insolvent. However, individual depositors cannot ordinarily make the kind of tests or examinations necessary to ensure that a warehouse operation, as a whole, is sound and solvent.

In 1916 the Congress passed the U.S. Warehouse Act (as amended 7 U.S.C. 241 et seq.) which was intended to improve the country's agricultural warehouse industry. Under the act the U.S. Department of Agriculture's (USDA's) Agricultural Marketing Service (AMS) administers a voluntary Federal licensing and examination program for warehouses storing agricultural commodities. The primary objectives of the act are to: (1) protect from loss the crops of producers and others who store their agricultural products in public warehouses, (2) assure the integrity of warehouse receipts as documents of title to be used as collateral for loans and to facilitate trading in interstate commerce of agricultural commodities, and (3) set and maintain a standard for sound warehouse operations.

The act requires licensed warehouses to issue receipts for all stored products as evidence that the depositor's products are in storage. All such receipts, printed under Government contract, must be ordered from USDA. A warehouse receipt may be issued only when the products are actually received in the licensed warehouse, and these receipts must be surrendered to the warehouse and canceled before the products may be removed from storage. Receipts issued under the act are supported by inspection and/or weight certificates issued by warehouse inspectors and weighers licensed under the act.

AMS administers the act mainly through a program of comprehensive warehouse examinations. Examiners review the warehouse's obligations to depositors as represented by outstanding warehouse receipts, scale tickets,<sup>1</sup> and customer account records. The examiners inventory all commodities on hand, comparing this inventory with the warehouse's record of obligations. They also review the warehouse's recordkeeping, housekeeping

---

<sup>1</sup>First source document to the depositor showing the weight of the grain when it went over the scales.

practices, sanitation, and insurance coverage and check the quality of the products in storage. When minor discrepancies or adverse conditions are found, warehouses are required to bring operations into compliance. When the discrepancies are considered serious, the warehouse's license may be suspended. The act provides for penalties of up to 10 years in prison and fines of up to \$10,000 for improprieties in connection with warehouse receipts or inspections and weighings.

The act is permissive in that it applies only to warehouses that voluntarily apply for a license and that are found to qualify. By maintaining a Federal license, warehouse operators demonstrate to their depositors that they meet Federal requirements for proper and sound warehouse operations. As of December 31, 1982, 1,685 grain warehouses were licensed under the act. This number represents about 17 percent of the estimated 10,000 grain warehouses in the United States.

USDA also sets requirements and examines warehouses storing commodities owned by the Commodity Credit Corporation (CCC) or pledged to CCC as loan collateral. CCC is a federally established corporation comprised of top-level USDA officials. In carrying out its various price-support programs, CCC contracts with public warehouses for storing and handling commodities which it owns or which have been pledged as collateral for Government loans. For grain, CCC enters into these contracts through uniform grain storage agreements (UGSAs).

CCC's storage contract functions are carried out by USDA's Agricultural Stabilization and Conservation Service (ASCS) because CCC has no employees of its own. ASCS sets the standards that CCC contract (UGSA) warehouses must meet. These standards are similar to AMS' requirements for federally licensed warehouses, the primary difference being that ASCS does not require warehouse operators to be bonded.

Under a memorandum of understanding with ASCS, AMS is responsible for determining the qualifications of the UGSA warehouses and their operators and for protecting the Government's interest in commodities stored in such warehouses. AMS does so through (1) initial examinations and investigations when contract applications are filed, (2) periodic subsequent examinations of the warehouses and the commodities stored therein, and (3) continuing reviews of the warehouses' operations and financial stability.

As of January 1983 CCC had storage contracts with 6,443 grain warehouses.

In 10 States examinations of some nonfederally licensed UGSA warehouses are carried out by State personnel rather than AMS personnel. AMS has cooperative agreements with 9 of the 10

States<sup>2</sup> and a collaborator agreement with Minnesota. Under these agreements State employees examine nonfederally licensed UGSA warehouses. (For Minnesota, State employees are trained and directly supervised by AMS personnel.) In both cooperative and collaborator agreement States, AMS personnel examine all federally licensed warehouses, even if they are UGSA warehouses.

#### STATEMENT OF THE PROBLEM

Storing grain in public warehouses has become increasingly risky, as evidenced by the increase in grain warehouse bankruptcies in 1982 (see p. 13), due to changes in the marketing operations of warehouses that buy and sell grain. The use of delayed price and deferred payment contracts has contributed to the possibility of increased losses to grain depositors. Delayed price and deferred payment contracts have lessened the amount of grain warehouse operators are required to have stored at any one time and increased their grain payable accounts, thereby contributing to a higher risk of loss for producers and CCC. Under these contracts, warehouses receive title to the grain but delay payment until the grain can be considered sold at a price or time agreeable to the producers. If the warehouse fails before payment is made, bankruptcy laws give certain creditors priority claim as to the warehouse's assets. The farmer holding the contract is, as an unsecured creditor, one of the last to be reimbursed.

The grain warehouse operator's financial problems are currently complicated further by the state of the overall economy and specific economic factors such as the high interest rates being charged for business loans and depressed grain prices.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

At the request of the Ranking Minority Member, Subcommittee on Agriculture, Rural Development, and Related Agencies, Senate Committee on Appropriations, and subsequent discussions with his office, our objectives were to

- review what USDA had done to implement recommendations in our June 19, 1981, report entitled "More Can Be Done To Protect Depositors at Federally Examined Grain Warehouses" (GAO/CED-81-112);
- review the impact of the fiscal year 1983 budget on USDA's ability to improve its inspection (examinations) activities; and

---

<sup>2</sup>The States of Idaho, Illinois, Iowa, Kansas, Missouri, Nebraska, Oregon, Washington, and Wyoming. As of January 1983 these States were responsible for 2,416 UGSA warehouses--about 37 percent of the 6,443 such warehouses on that date.

--provide updated information on the extent of financial problems in the grain warehouse industry.

To accomplish these objectives, we reviewed applicable Federal regulations and pertinent USDA policies, procedures, and program records. We interviewed USDA program officials in Washington, D.C., and Kansas City, Missouri, including the chairman of USDA's Warehouse Task Force. The task force was to review grain warehouse laws and regulations, research available data and public impact pertaining to the problems existing in identifying and preventing elevator bankruptcies, and recommend possible changes to lessen the likelihood of such insolvencies. We also interviewed officials of the National Grain and Feed Association, National Council of Farmers Cooperatives, and National Grain Trade Council.

We obtained detailed information on:

- USDA progress toward developing and implementing a predictive formula for identifying potential grain warehouse bankruptcies as we had recommended.
- Changes to USDA's warehouse examination and financial data review procedures in areas related to our recommendations.
- Regulations USDA has proposed or finalized since our prior review.
- USDA resources being applied/budgeted for grain warehouse examinations and changes in the frequency of such examinations.
- Warehouses that, since our last review, had filed for bankruptcy or liquidated.
- Actions taken against warehouses that violated, or were suspected of violating, CCC contract terms.

We made this review in accordance with generally accepted government auditing standards. Our audit work was done from May 1982 through March 1983 primarily at AMS' Warehouse Division and ASCS' Transportation and Storage Division in Washington, D.C., and at AMS' National Warehouse Service Center, ASCS' Commodity Office, and the Office of Inspector General's regional office, all in Kansas City, Missouri.



## CHAPTER 2

### USDA ACTIONS ON RECOMMENDATIONS MADE

#### IN OUR PRIOR REPORT

Our June 1981 report recommended seven changes to USDA's warehouse examination and financial review procedures which we believed would strengthen protection provided to grain depositors. The recommendations can be placed in three groups--one recommending that USDA develop and implement a formula for identifying warehouses with financial problems, three recommending changes to improve warehouses' reporting of financial data, and three recommending changes to improve procedures for examining warehouses.

A new, but related, issue has surfaced since our 1981 report. The new issue concerns the need for USDA to better ensure the reliability of financial data warehouses are submitting. This new issue is discussed later in this chapter.

#### DEVELOPMENT AND USE OF A PREDICTIVE FORMULA

We reported in 1981 that a significant number of grain warehouses may be in financial difficulty--an estimated 300 of the 6,400 warehouses then subject to Federal examination--and that a reliable formula for predicting those that may go bankrupt in the foreseeable future offered considerable potential for making the Federal warehouse examination program more effective.

Accordingly, we recommended that the Secretary of Agriculture direct the AMS Administrator to develop and implement a predictive formula for grain warehouse bankruptcies. We stated that a predictive formula would be useful in determining the magnitude of the potential bankruptcy problem and in establishing priorities and frequencies for Federal examinations.

#### USDA actions

AMS identified only one researcher--Dr. John W. Siebert, Extension Economist, University of California at Davis--who was performing research on predictive formulas for financially troubled grain elevators. At AMS' request, on March 9, 1982, Dr. Siebert presented a seminar on his work to AMS personnel. Subsequently, AMS requested Dr. Siebert to do additional work on his models (predictive formulas) using historical data provided by AMS.

AMS statisticians reviewed Dr. Siebert's models to determine whether they could either improve them or develop a better formula. An AMS analysis of Dr. Siebert's models was completed in September 1982. The analysis identified some information for determining the ability of Dr. Siebert's models to generate

early warnings for grain warehouse bankruptcies. Several problems became apparent from the analysis, and additional information was needed for AMS to proceed with its research. However, AMS has tested one of Dr. Siebert's models on 300 warehouses. The test, which was designed to show differences between known financial conditions and the predictive capabilities of the model, showed that the model did not accurately identify all healthy and bankrupt warehouses.

### Our evaluation

USDA is proceeding with the development of a predictive model as we recommended. It has reviewed several models and has tested one of them to determine if it is capable of identifying known conditions. Although the test was not entirely successful, AMS believes that adjustments can be made to the model and that it can be implemented in the fall of 1983. AMS also plans to continue to refine the model once it is operational.

### FINANCIAL DATA SUBMITTED BY WAREHOUSES HAS IMPROVED

We reported in 1981 that the financial data warehouses submitted to USDA was insufficient for USDA to properly analyze and determine warehouses' financial health and to compute financial ratios for identifying financially troubled warehouses. We also reported that USDA had no assurance that the financial data warehouses submitted was consistent.

To correct these problems, we recommended that USDA require federally examined warehouses to submit financial data that would be sufficient to (1) properly analyze and determine warehouses' financial health and (2) compute the financial ratios for identifying financially troubled warehouses. We also recommended that warehouses be required to submit financial data in conformity with generally accepted accounting principles. Further, we recommended that USDA provide warehouses with written instructions on how to report financial data.

### USDA actions

USDA amended its regulations to require that, effective July 1, 1982, all federally examined warehouses submit annual financial statements in conformity with generally accepted accounting principles. The specific statements required are a balance sheet, a statement of income (profit and loss), a statement of retained earnings, and a statement of changes in financial position.

### Our evaluation

The financial statements USDA now requires are sufficient to provide the financial data it needs to properly analyze and

determine warehouses' financial health and to compute the financial ratios for identifying financially troubled warehouses. Further, the requirement that the statements be in conformity with generally accepted accounting principles is consistent with our recommendation to that effect and also satisfies our recommendation for written instructions.

We agree with USDA that written instructions do not have to be provided to warehouses if financial statements are to be prepared in conformity with generally accepted accounting principles, provided that the financial statements USDA requires from warehouses are accompanied by an audit report. Without an audit, the additional assurance that the statements are prepared in conformity with generally accepted accounting principles would not exist.

#### USDA HAS IMPROVED ITS PROCEDURES FOR EXAMINING WAREHOUSES

We reported in 1981 that certain weaknesses existed in USDA's warehouse examination procedures. The weaknesses centered around problems in verifying warehouses' storage obligations. Accordingly, we recommended that USDA ensure that all CCC contract grain warehouses use warehouse receipts that can be accounted for during Federal warehouse examinations. We also recommended that USDA require all federally licensed and CCC contract grain warehouses to give depositors warehouse receipts for all storage grain as soon as is practicable after delivery is completed. Further, we recommended that grain storage obligations reflected on warehouse customer account records be verified with a statistical sample of depositors as part of normal subsequent examination procedures employed at federally licensed and CCC contract grain warehouses.

#### USDA actions

As discussed in the next section, USDA has issued additional requirements related to the financial data warehouses are to submit. The additional requirements are geared to improve the reliability of warehouses' financial data. Improved reliability encompasses the verification of warehouses' storage obligations.

#### Our evaluation

The additional requirements USDA issued are an important step toward improving the reliability of warehouses' financial data and toward lessening the weaknesses centered around the problems in verifying warehouses' storage obligations. To the extent that USDA makes further changes in its requirements, as we recommend in the next section, we believe there will be no need for USDA to respond further to our specific 1981 recommendations for improving its examination procedures.

STEPS TAKEN TO IMPROVE THE RELIABILITY  
OF WAREHOUSES' FINANCIAL DATA

Amended AMS and CCC regulations, which became effective July 1, 1982, require all warehouse operators licensed under the U.S. Warehouse Act and/or having a UGSA contract to submit current financial statements prepared in accordance with generally accepted accounting principles. The financial statements are to include, but not be limited to, a balance sheet, a statement of income (profit and loss), a statement of retained earnings, and a statement of changes in financial position. All financial statements are to be accompanied by a certification by the chief executive officer of the warehouse, under penalty of perjury, that the financial statement(s) accurately reflects the financial condition of the warehouse operations for the period specified in such statement.

The AMS regulations further provide that warehouses licensed under its regulations should have financial statements audited by an independent certified public accountant (CPA). However, financial statements audited or reviewed by an independent public accountant will be accepted subject to an additional onsite examination and audit by the Secretary. AMS regulations also state that audits and reviews by independent CPAs and independent public accountants should be made in accordance with standards established by the American Institute of Certified Public Accountants.

CCC regulations provide an alternative to financial statements audited by independent CPAs or independent public accountants. Under CCC regulations, each financial statement is to be accompanied by one of the following:

- A report of audit or review conducted by an independent CPA or an independent public accountant in accordance with standards established by the American Institute of Certified Public Accountants. The accountant's report of audit or review shall include the accountant's certifications, assurances, opinions, comments, and notes with respect to such financial statement.
- A compilation report<sup>1</sup> of the financial statement which is prepared by a grain commission firm or a management firm if such firm has been authorized by the Deputy Vice

---

<sup>1</sup>Compilation reports are not allowed for federally licensed warehouses. They are limited to presenting, in the form of financial statements, information that is provided by management. No auditing or reviewing has been done and, accordingly, no opinion or any other form of assurance is given.

President of CCC to provide a compilation report of financial statements of warehouses.

Warehouse operators also have been put on notice that a representative of the Office of the Secretary may be requested to examine the books, records, papers, and accounts of the warehouse operator whenever a financial statement and report, other than one examined by an independent CPA and accompanied by a CPA-prepared audit report on such financial statement, is received.

#### Our evaluation

AMS regulations provide that financial statements may be reviewed by an independent public accountant. CCC's regulations allow for the submission of review reports or compilation reports with warehouse financial statements. We believe that neither regulation provides USDA with sufficiently reliable financial information on the warehouses.

Reviews and compilations differ significantly from audits of financial statements. The objective of an audit is to provide an evaluation of a company's system of internal controls, inspection of documents, observation of assets, and other accounting procedures for expressing an opinion regarding the financial statements taken as a whole. A review does not necessarily include a study and evaluation of internal accounting control; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation; and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.

In a compilation report, the accountant does not express any opinion on the financial statements. The accountant is required only to present, in the form of financial statements, information that is presented by management.

An audit report that contains an unqualified opinion provides reasonable assurance that an entity's financial statements are fairly presented. Fair presentation, in turn, promotes reliability. However, if the auditor believes the financial statements are not fairly presented, or is unable to determine if the statements are fairly presented, the auditor's report will include either a qualified opinion,<sup>2</sup> adverse

---

<sup>2</sup>The financial statements are fairly presented in conformity with generally accepted accounting principles "except for" or "subject to" the effects of the matter to which the qualification relates.

opinion,<sup>3</sup> or disclaimer of opinion.<sup>4</sup> Because of the importance of reliability, USDA could encourage or direct warehouses to correct or improve those conditions or factors which caused the auditor to render a qualified opinion, adverse opinion, or disclaimer of opinion. Until the necessary corrections and improvements are made, USDA would not be able to fully rely on a warehouse's financial statements.

We recognize that an additional cost would be imposed on warehouses by requiring them to submit financial statements audited by independent CPAs or independent public accountants. We also recognize that it is difficult to quantify the benefits of audited financial statements so that an effective, quantitative, cost-benefit analysis can be made. However, we believe that financial statements audited by independent CPAs or independent public accountants would provide USDA and depositors at federally examined grain warehouses with greater assurance that the warehouses' financial statements are reliable. The audited statements would provide depositors with a better indication as to the warehouses' financial condition.

The Office of Management and Budget (OMB) has reviewed USDA's regulations and has commented that it would prefer to accept only audits made by CPAs and independent public accountants.

#### RECOMMENDATION TO THE SECRETARY OF AGRICULTURE

Although USDA has made changes in its financial reporting regulations, we recommend that USDA revise its regulations to require that federally examined warehouses submit annual financial statements accompanied by an audit report prepared by an independent certified public accountant or independent public accountant.

#### AGENCY COMMENTS AND OUR EVALUATION

We requested and received comments from the Department of Agriculture on our draft report. The Department generally concurred in the report's factual content.

The Director, Transportation and Storage Division, ASCS, stated that the report shows differences in AMS and CCC reporting requirements. He believes that the reporting requirements

---

<sup>3</sup>The financial statements as a whole are not fairly presented in conformity with generally accepted accounting principles.

<sup>4</sup>The auditor has not performed an examination sufficient in scope to form an opinion on the financial statements.

are the same for the two agencies with the exception that CCC allows for a compilation report. Our discussion of the specific reporting requirements for the two agencies is found on page 8.

From an accounting viewpoint, the Director agreed with our evaluation that financial statements accompanied by an audit report prepared by an independent CPA or by an independent public accountant would provide the most reliable indication of a warehouse's financial condition. However, he said that from an operations viewpoint, he believed the financial information contained in compilation reports provides CCC with adequate assurance as to warehouses' solvency. He also stated that CCC has certain standards that management or commission firms must meet before CCC will allow them to submit compilation reports as part of a warehouse's financial statements.

Because a compilation report does not contain an accountant's opinion on the warehouse's financial condition, we believe it does not provide sufficiently reliable financial information. We believe that annual financial statements accompanied by an audit report prepared by an independent CPA or independent public accountant containing the accountant's opinion of the financial statements provide a more reliable indication of a warehouse's financial condition.

Regardless of the CCC standards for management or commission firms, a compilation report does not contain an opinion by an accountant on a warehouse's financial statements. As a result, a compilation report does not provide adequate assurance as to the reliability of a warehouse's financial statements. For that reason, we believe that adequate assurance can be achieved if a warehouse's financial statements are accompanied by an audit report containing an opinion by an independent CPA or independent public accountant.

### CHAPTER 3

#### UPDATED INFORMATION ON THE EXTENT OF THE GRAIN WAREHOUSE INDUSTRY'S FINANCIAL PROBLEMS

Industrywide data is not available to measure increases or decreases in the financial health of the grain warehouse industry. USDA officials and industry representatives that we talked with said that they had no basis for determining whether the industry's overall financial condition had improved or worsened. However, based on data that we compiled from May 1982 through March 1983 on items that we believe to provide some indication of the industry's financial condition, we believe that the industry's financial problems have not lessened since our June 1981 report. The items we compiled data on are

- nonfederally licensed warehouses with UGSAs that have filed for bankruptcy or liquidated,
- the status of the 19 warehouses which we identified as being in financial trouble during our prior audit,
- UGSA warehouses which have been reviewed for possible irregularities in the amount and quality of grain in storage, and
- cases referred to the Office of Inspector General (OIG) for investigation since January 1973.

Because of the large number of privately owned grain warehouses, industrywide financial data is not available to perform routine periodic analyses of the financial condition of this industry similar to those analyses made of other industries (such as the automobile, steel, oil, and banking industries). Also, we did not find any special studies of the grain warehouse industry current enough to indicate whether the overall financial condition of the industry had improved or worsened since our June 1981 report.

#### USDA AND INDUSTRY VIEWS

USDA officials and the grain industry representatives we talked with said that warehouse operators are affected by depressed grain prices, high interest rates charged on business loans, and other general economic problems but are probably no worse off than other sectors of the U.S. economy. As stated previously, the officials and representatives said that they had no basis for determining whether the industry's overall financial condition had improved or worsened.

A representative of the National Grain and Feed Association pointed out that it is not always the depositors that are being hurt by the bankruptcy of a grain warehouse; sometimes it is the bankruptcy of depositors that hurt a warehouse. We noted that



this was the case for one warehouse operator that had its license suspended. The examiner had found that the warehouse was in an oversold position which the operator attributed to a cash flow problem. This warehouse was owed over \$200,000 by a farmer and a grain buyer, both of whom had filed for bankruptcy.

UGSA WAREHOUSES THAT HAVE FILED FOR BANKRUPTCY OR LIQUIDATED

In 1979 ASCS began compiling data on CCC contract (UGSA) grain warehouse companies that filed for bankruptcy or liquidation. That data shows that the number of warehouses in financial trouble is increasing. From January 1979 through February 1983, ASCS identified 61 UGSA warehouses that filed for bankruptcy or liquidated--11 in 1979, 14 in 1980, 6 in 1981, 23 in 1982, and 7 during the first 2 months of 1983. Following is a further breakdown by type of liquidation.

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983<sup>a</sup></u>
Bankruptcy	5	6	4 <sup>b</sup>	16	5
Liquidation					
State	3	6	2	5	1
Nonstatutory/voluntary	1	0	0	1	0
Receivership--State	1	2	0	0	1
Consent agreement	0	0	0	1	0
Abandoned	<u>1</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>11</u>	<u>14</u>	<u>6</u>	<u>23</u>	<u>7</u>

<sup>a</sup>Through February 25, 1983.

<sup>b</sup>Includes two federally licensed warehouses.

We reviewed USDA records on 15 of the 27 (an additional 2 were federally licensed) nonfederally licensed warehouses filing for bankruptcy or liquidating in 1981 and 1982 and found that 10 were short of grain during the Federal warehouse examinations. We were told by the assistant officer-in-charge of AMS' National Warehouse Service Center that 5 of the 10 shortages could result in substantial losses to the depositors.

UPDATE ON WAREHOUSES IDENTIFIED IN OUR PRIOR REPORT AS BEING IN FINANCIAL TROUBLE

In our June 1981 report, we identified 19 warehouses that we projected could be in financial trouble. To obtain a further index of the warehouse industry's financial condition, we determined the current operating status of these 19 warehouses. As of March 28, 1983, only eight of these warehouses were still in

operation under the same owner. Of the others, six had been sold, one had been merged with another warehouse, one was in the process of being sold, one was in the process of being liquidated, and two had their licenses canceled.

CASES INVOLVING SUSPECTED OR  
REPORTED CCC CONTRACT VIOLATIONS

The ASCS Adverse Reporting Review Committee was established to promptly review cases involving suspected or reported quantity shortages, quality deteriorations, and other adverse warehouse conditions involving warehouses with UGSAs. This committee, composed of Kansas City Commodity Office (KCCO) personnel and located in Kansas City, is responsible for recommending the actions KCCO should take on the cases brought before it.

Our review of the cases submitted to the adverse committee, which had been recorded by its secretary since July 1975, revealed increases in the number of cases and the severity of the classifications assigned to the cases. Also, an increased number of cases had been referred to USDA's OIG for investigation. We believe an increase in the number of cases referred and in the severity of classification is a further indication of financial problems in the warehouse industry. More detailed information regarding the trends in the number of cases sent to the adverse committee, the actions the adverse committee had taken, and the requests for OIG investigations is provided in the following sections.

Trends in the number of cases  
sent to the adverse committee

If a warehouse is found to be in an oversold position, exceeding either 3 percent of its total capacity or 10,000 bushels, during an examination (whether AMS or State examined), AMS notifies KCCO, and the adverse committee must meet to review the case. The main purpose of this meeting is to classify the case based on the available information. The four classifications are as follows:

- Operational--The shortage can be explained as other than an intentional violation of the contract (that is, occasioned by shrinkage, normal handling losses, or honest errors).
- Unclassified--No explanation exists for the shortage and no evidence exists of intentional violation of the contract.
- Suspected contract violation--Evidence exists of intentional violation of the contract.
- Contract violation--Proven violation of the contract (only one case since 1975 had been classified as a contract violation).

We reviewed cases which required adverse committee action since July 1975 to obtain information regarding the trend in the number of cases sent to the adverse committee and the severity of the cases. From July 1979 to March 1983 the number of cases which required committee action and the severity of cases (suspected contract violation) increased significantly. Some of the suspected contract violation cases involved quantity shortages or quality deterioration which could result in financial difficulties for those warehouses. A summary of the information we obtained is shown below.

Number of Cases Requiring Adverse Committee Action

<u>Period</u>	<u>Operational</u>	<u>Unclassified</u>	<u>Suspected contract violation</u>	<u>Contract violation</u>	<u>Classification not evident</u>	<u>Total</u>
July 1975 to June 1976	10	2	0	0	1	13
July 1976 to June 1977	9	4	0	0	2	15
July 1977 to June 1978	14	2	0	0	1	17
July 1978 to June 1979	15	6	0	0	2	23
July 1979 to June 1980	23	6	8	0	2	39
July 1980 to June 1981	19	23	10	0	5	57
July 1981 to June 1982	18	15	14	1	0	48
July 1982 to March 1983	<u>21</u>	<u>13</u>	<u>16</u>	<u>0</u>	<u>5</u>	<u>55</u>
Total	<u>129</u>	<u>71</u>	<u>48</u>	<u>1</u>	<u>18</u>	<u>267</u>

REQUESTS FOR OIG INVESTIGATIONS

The adverse committee is to request an OIG investigation of cases which have been classified as "unclassified," "suspected contract violation," or "contract violation." As the table on the following page shows, the number of cases which the adverse committee referred to OIG increased steadily since 1977. We believe that this increase in referral is yet another indication of a financially troubled warehouse industry.

OIG Warehouse Investigation Activity

<u>Calendar year</u>	<u>Total number of requested investigations</u>
1973	47
1974	41
1975	14
1976	17
1977	9
1978	13
1979	29
1980	38
1981	39
1982	58
1983 <sup>a</sup>	11

<sup>a</sup>Through March 30, 1983.

## CHAPTER 4

### IMPACT OF USDA FISCAL YEAR 1983 BUDGET ON USDA'S

#### ABILITY TO IMPROVE ITS INSPECTION ACTIVITIES

The amount of staff time expended on warehouse examinations and the frequency of such examinations have been reduced each year from 1979 to 1983. According to USDA officials, the 1983 reductions were made not because of budget limitations (in fiscal year 1983 warehouses will pay for all or part of the examination costs) but because they believed improvements to the program, resulting from recent amendments to AMS' and CCC regulations, would result in an inspection program that is as good or better even with these reductions. However, we believe that the reductions were premature because (1) the information which will be obtained through review or compilation reports may not provide USDA with sufficiently reliable financial information and (2) development of predictive formula(s) has not progressed to the point where it can be used to establish priorities and frequencies for warehouse examinations. In addition, the fiscal year 1983 appropriation contains no funds for OIG warehouse audits and funds for only a limited number of special warehouse examinations that are undertaken when suspected problems are identified.

#### FUNDING OF USDA'S WAREHOUSE EXAMINATION PROGRAM

Section 158 of the Omnibus Budget Reconciliation Act of 1981 amended the U.S. Warehouse Act to require that the Secretary of Agriculture, or a designee, assess user fees to cover costs associated with examinations and licensing of all warehouses licensed under the act. Because CCC contracts with federally licensed warehouses in the conduct of its business and thereby benefits from the services provided under the Warehouse Act, USDA determined that CCC should pay a portion of these service costs. Therefore, the warehouse operators and CCC together pay the cost representing user fees as mandated by the Omnibus Budget Reconciliation Act for those warehouses licensed under the Warehouse Act that have a UGSA.

Before July 1982 CCC had paid the States for part of the costs the States incurred in the examinations they made pursuant to Federal/State cooperative agreements. In addition, CCC had reimbursed AMS for all costs of examining warehouses that were neither federally licensed or licensed by the States having a Federal/State cooperative agreement. To prevent federally licensed warehouses with a UGSA from withdrawing from the Warehouse Act program so that they could obtain the Federal examination with CCC paying the entire cost, CCC amended its regulations to provide for collecting a contract fee from the UGSA warehouse operators that are not licensed either under the

Warehouse Act or by States having a Federal/State cooperative agreement. The contract fee is determined using the same formula as that used to assess fees for federally licensed warehouses.

USDA still pays the entire cost of special warehouse examinations; that is, nonroutine examinations undertaken because of suspected problems. CCC pays for all special examinations at UGSA warehouses and AMS pays for all such examinations at federally licensed warehouses that do not have a UGSA. The appropriate agency also reimburses OIG for any warehouse audits that are requested.

#### REDUCTION IN USDA WAREHOUSE EXAMINATION PROGRAM ACTIVITY

In recent years both the number of examiner hours expended on grain warehouse examinations and the frequency rate for such examinations have declined. The number of hours expended by AMS examiners for examinations under the Warehouse Act and for non-federally licensed warehouses with a UGSA declined from 135,951 hours in fiscal year 1979 to 129,234 hours in fiscal year 1980 and to 121,211 hours in fiscal year 1981. For fiscal year 1982 a total of 106,673 hours were expended. For fiscal year 1983 (through Mar. 19, 1983) a total of 49,754 hours were expended. This would equate to about 90,801 hours annually.

The agreement between ASCS, CCC, and AMS regarding the frequency of and payment for warehouse examination services provided that between October 1, 1981, and June 30, 1982, AMS would perform at an annual average rate of 1.7 routine examinations on those UGSA warehouses subject to the Warehouse Act--this rate approximates the average actual rates in the preceding 3 years: 1.76 in 1979, 1.61 in 1980, and 1.72 in 1981. After July 1, 1982, however, AMS is to average only 1 routine examination per year on all UGSA warehouses. AMS' fiscal year 1983 budget called for an average of 1.3 examinations, but this includes 0.3 special examinations. It also provides for continuing an average of 1 routine examination per warehouse per year on UGSA warehouses not subject to the Warehouse Act.

According to ASCS' Deputy Administrator for Program Planning and Development, USDA officials determined that the regulatory changes discussed in chapter 2, which required additional financial information starting July 1, 1982, made it possible to reduce the frequency of examinations and maintain an equal or possibly better program. The changes referred to included:

- Obtaining additional information from the annual financial statements.

- Making those financial statements that are not audited or reviewed by a CPA subject to additional onsite examinations or audits by USDA (audits would be performed either by OIG or by a CPA under contract with OIG).
- Requiring the chief executive officer for the warehouse operator to certify under penalty of perjury that the financial statements submitted to USDA accurately reflect the financial condition of the warehouse operator as of the date named and fairly represent the result of operations for the period named.

The Deputy Administrator, who also served as the Chairman of USDA's Grain Elevator Task Force working group, said that the working group had recommended the 1.0 frequency rate for routine examinations. He said that ASCS can, and does, request special examinations when indications show that a warehouse may have problems. Therefore, the overall frequency rate will continue to exceed 1.0.

USDA officials (the Executive Assistant to the Secretary, who also served as Chairman of the Warehouse Task Force's executive committee; ASCS' Deputy Administrator for Program Planning and Development; and the Director of AMS' Warehouse Division) said that availability of funds was not a factor in the decision to reduce the frequency of warehouse examinations. In fiscal year 1983 warehouses licensed under the Warehouse Act will pay for the cost of the examination, whereas those warehouses with UGSA contracts will pay for half the examination cost and the remainder will be paid by CCC.

Some USDA officials did not agree with the decision to reduce the frequency of warehouse examinations. For example, Warehouse Division officials expressed concern about the reduction, which they said will likely cause operators to get sloppy with warehouse records and increase the number of records the examiner will have to review. As a result, individual examinations will take longer and, with the greater time lapse between examinations, the greater the probability will be that warehouses' financial problems/shortages of grain will go undetected for a long period.

#### Our evaluation

We believe that the reduction in the frequency of warehouse examinations was premature considering the warehouse industry's current financial condition as discussed in the previous chapter. We also believe reductions should not have been made because the development of a predictive formula has not progressed to the point where it can be used to establish priorities and frequencies for examinations. Further, the reduction decision was based, in part, on the belief that the amended regulations would provide USDA with better financial information

on the warehouses; however, as noted in chapter 2, the information which will be provided through review or compilation reports, does not provide USDA with sufficiently reliable financial information.

(022853)





25726

**AN EQUAL OPPORTUNITY EMPLOYER**

**UNITED STATES  
GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548**

**OFFICIAL BUSINESS  
PENALTY FOR PRIVATE USE \$300**

**POSTAGE AND FEES PAID  
U. S. GENERAL ACCOUNTING OFFICE**



**THIRD CLASS**