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Statement of

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Before the

Subcommittee on Wheat, Soybeans, and Feed Grains
Committee on Agriculture
House of Representatives

on a

General Accounting Office Review of the
Department of Agriculture's Grain Warehouse
Examination Programs

Mr. Chairman and Members of the Subcommittee:

We are here today at your request to discuss the results of our review of the Department of Agriculture's (USDA's) grain warehouse examination programs. Our report to the Secretary of Agriculture, issued on June 19, 1981, was entitled "More Can Be Done To Protect Depositors At Federally Examined Grain Warehouses" (CED-81-112). Grain warehouse bankruptcies over the past few years and the publicity given a few recent cases have heightened concern about Federal and State warehouse licensing and examination programs.

The Department of Agriculture and at least 29 grain-producing States administer programs to ensure that producers and the Federal Government have safe storage facilities for their agricultural commodities.



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The purpose of our review was to

- Determine the past magnitude of the bankruptcy problem and the number of warehouses in financial difficulty.
- Identify some ways the current Federal programs could be strengthened.
- Identify issues that should be considered in evaluating certain possible program and legislative changes.

Past Bankruptcies and Future Estimates

The best overall and latest available data on past bankruptcies indicates that about 2 percent of the approximately 10,000 grain warehouses nationwide have gone bankrupt between 1974 and 1979. Most of the reported bankruptcies for which information was available were warehouses in business less than 5 years and which had a capacity of less than 300,000 bushels.

We are unaware of any scientific predictions of the number of warehouses that may go bankrupt in the future. USDA requires federally examined warehouses to submit certain financial data, but its requirements and review procedures are not aimed at detecting financially unsound warehouses. Financial formulas for predicting bankruptcies in certain industries have been developed and shown to be reasonably accurate in tests on past cases. The Federal Deposit Insurance Corporation also uses financial ratio tests to identify banks with deteriorating conditions before they become serious. A predictive formula specifically tailored to grain warehouses does not exist, and formulas for other industries currently cannot be applied to grain warehouses.

To estimate how many warehouses might be in financial trouble, we applied certain financial ratios and self-developed criteria to data reported to the Department by a random sample of 400 grain warehouses under Federal jurisdiction. We found that 19, or 4.75 percent, of the sample warehouses met our criteria for being in financial trouble. Based on these results, we estimate that about 300 warehouses may be financially unsound. At the 95-percent confidence level, this number could range from 173 to 427 warehouses. These results do not mean that 300 bankruptcies are likely to occur in the near future. However, we believe these results indicate that more accurate forecasts of future bankruptcies are needed.

No predictive formula will ever be totally accurate. Even though the grain industry is volatile, a predictive formula could be a great help in identifying possible bankruptcies. At the time of our review, the Department was considering what actions it should take when insolvencies were likely to occur. Before deciding this, it should have developed a predictive formula to better determine the number of potential bankruptcies. This information, in our opinion, is necessary to determine what, if any, actions would be appropriate, such as special supervisory attention or additional examinations. To develop such a formula, however, the Department will have to require warehouse operators to provide certain sales data in addition to financial data they now must report. This data could be obtained with only minor changes in current requirements and would enable the Department to compute and determine the trend of commonly used financial ratios that indicate financial health.

Our report recommended that the Secretary of Agriculture

--Require federally examined warehouses to submit the financial data necessary to compute commonly used ratios indicative of financial health.

--Develop and implement a predictive formula for grain warehouse bankruptcies. This formula would be useful in determining the magnitude of the potential bankruptcy problem and in establishing priorities and frequencies for Federal examinations. It should be developed before the Department decides what actions to take on threatened insolvencies.

In responding to our recommendations as required by Section 236 of the Legislative Reorganization Act of 1970, the Secretary generally agreed with our recommendations and said that the Department will require a financial statement opinion by a certified public accountant. The statement is to contain the financial data needed to formulate generally accepted ratios which will be available for consideration in the development of a formula to predict grain warehouse failures. The Secretary said also that the Department would work toward developing a predictive formula that would help in identifying problem warehouses.

Federal Warehouse Programs Needed Strengthening

Certain weaknesses in Federal warehouse programs made it difficult to ensure that warehouses had a sufficient quantity and quality of grain to cover their storage obligations--the basic purpose of the programs as now structured.

Federally examined warehouses did not always issue warehouse receipts for grain placed in storage because the Department did not require them to do so. In these cases, examination procedures were of little value because all storage obligations were not backed by reliable documentation and because examiners did not

verify with depositors the storage obligations shown in warehouse records. The Deputy Director, Inventory Management Division, Agricultural Stabilization and Conservation Service, said this verification would increase examination time. We believe the time would be worthwhile, considering the added assurance it would provide.

Many States did not control the printing and distribution of receipts. As a result, examiners could not be sure they had accounted for all receipts when examining nonfederally licensed Commodity Credit Corporation (CCC) contract warehouses in those States. This situation jeopardized the purpose of the examination and made it difficult to detect if operators had improperly issued receipts as loan collateral on grain they did not own.

The Department required operators to submit certain financial data at least annually but did not require certified statements. It reviewed this data to ensure that warehouses continued to meet net asset and bonding requirements of the U.S. Warehouse Act or CCC regulations, as appropriate.

We made a number of recommendations to the Secretary which we believed would strengthen the Federal warehouse programs. The Department, among other things, agreed to require that warehouse receipts in warehouses under uniform grain storage agreements will be reconciled, and that all financial statements will have to be prepared in accordance with generally accepted accounting principles.

Some of the actions already taken or planned to be taken by the Department should improve the protection afforded depositors at federally examined grain warehouses. I should mention at this point that the Federal programs, no matter how effective, do not provide protection for all grain depositors. About 36 percent of grain warehouses are subject only to State requirements, which range from nonexistent to very stringent. Although we did not evaluate the effectiveness of State requirements and examination programs, differences in basic protective requirements, such as net assets and bonding, suggest a corresponding variance in the degree of protection afforded depositors. The report contains appendixes that provide information on State grain warehouse licensing requirements, Federal/State bonding requirements for grain warehouses, and Federal/State net asset requirements for grain warehouses.

Issues To Consider In Revising
Current Federal Programs

Our report identified other issues regarding certain specific alternative changes to the programs which we believe USDA should address before major changes are implemented. Based on our work, we believe the grain elevator bankruptcy problem warrants further careful study and evaluation before major program and legislative changes are made. One overriding issue that we believe USDA should resolve before specific changes are decided on is whether the potential for future bankruptcies warrants significant expansion of Federal efforts.

The answer to this question is currently unknown. Obtaining a reliable answer will require development of a sound predictive formula tailored to the grain warehouse industry. The technology needed to do so currently exists, and research in this area is underway. To ensure against unnecessary additional Federal costs and regulations, we believe the need for any major expansion of the current Federal effort needs to be justified on the basis of reliable evidence that a significant number of bankruptcies are likely to occur in the future.

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This concludes my statement. I have attached a listing of other studies and legislative proposals that have been made in response to the grain elevator bankruptcy issue as well as the objectives and scope of our review as an appendix to my testimony. We shall be glad to respond to your questions.

Other Studies and Legislative Proposals

In addition to our review, begun in January 1981, other studies and legislative proposals have been made in response to the grain elevator bankruptcy issue.

- On February 26, 1981, the Secretary of Agriculture appointed a USDA task force to review current grain warehouse laws and regulations. Testimony on its study was presented before the Senate Judiciary Committee's Subcommittee on the Courts on May 18, 1981. Its final report was issued on August 18, 1981.
- On March 18, 1981, the National Association of State Directors of Agriculture, at the request of the Secretary of Agriculture, established a task force to study and make recommendations to the Secretary on the problem of grain elevator bankruptcies and failures. Its recommendations were sent to the Secretary on May 6, 1981.
- In March 1981 the Illinois Legislative Council issued a report "Grain Elevator Bankruptcies in the U.S.: 1974 through 1979."
- Four bills to amend the Bankruptcy Reform Act of 1978 relating to grain warehouses were introduced in the Congress during March 1981 (S. 839 by Sen. Dole, H.R. 2926 by Rep. Emerson, H.R. 2582 by Rep. Coleman, and H.R. 2593 by Rep. Glickman). Hearings on the Dole bill and grain elevator bankruptcies were held by the Senate Judiciary Committee's Subcommittee on the Courts on April 6 and May 18, 1981.
- A bill (H.R. 2523) to establish a national insurance program to protect against losses caused by public grain warehouse insolvencies was introduced in the Congress by Representative Albosta on March 17, 1981.
- Bills to strengthen warehouse laws, establish insurance programs, or amend State insolvency laws are being drafted or have been introduced or passed in at least nine State legislatures.

Objective and Scope of Review

In order to avoid duplication with the other studies mentioned above and to provide Congress with data on the extent of the problem, our objectives on this assignment were to:

- Determine the past magnitude of the bankruptcy problem and the number of warehouses in financial difficulty.

--Identify some ways the current Federal programs could be strengthened.

--Identify issues that should be considered in evaluating certain possible program and legislative changes.

Although we obtained information on related laws and programs from 29 States, we concentrated our work on Federal licensing and examination programs because of our direct statutory audit authority to examine them and because they were the only programs on which USDA had readily available data.

We interviewed officials of the National Grain and Feed Association in Washington, D.C., and obtained the views of other industry and farm groups and State agencies by reviewing their public comments to the USDA task force and testimony presented at hearings before the Senate Judiciary Committee's Subcommittee on the Courts. We also contacted two grain warehouse bonding companies and obtained information on financial requirements warehouses must meet to obtain a bond.

We coordinated our work closely with the USDA task force on grain elevator bankruptcies and attended several meetings of the task force working group. We also coordinated our work with USDA's Office of Inspector General. We interviewed its personnel knowledgeable in the area and reviewed its applicable audit reports.