

July 1990

FINANCIAL AUDIT

Export-Import Bank's
1989 and 1988
Financial Statements

141825

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**Comptroller General
of the United States**

B-197710

July 19, 1990

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

This report presents our opinion on the financial statements of the Export-Import Bank of the United States for the years ended September 30, 1989 and 1988, and our reports on the bank's internal control structure and on its compliance with applicable laws and regulations. We conducted our examination pursuant to 31 U.S.C. 9105 and in accordance with generally accepted government auditing standards.

Since fiscal year 1983, we have reported the need for the bank to reflect an allowance for possible losses associated with its portfolio of foreign loans and insurance and guarantee claims. The bank's fiscal year 1989 financial statements present for the first time an allowance for possible losses totaling \$4.8 billion associated with its \$12.1 billion foreign loans and claims portfolios. The bank's 1988 financial statements included herein have been changed to show the losses associated with the impairment of the foreign loans and claims portfolios that occurred prior to fiscal year 1989. This change increased the bank's accumulated deficit from \$116 million to \$3.4 billion at September 30, 1988.

The bank's reported \$1.9 billion net loss in fiscal year 1989 was principally due to the continued impairment of the bank's foreign loans and claims portfolios. As a result of this loss, the bank's accumulated deficit at September 30, 1989, was \$5.3 billion.

To assist the Congress in its oversight responsibilities for the bank, we believe the Congress needs to enact a recapitalization plan that restores the bank's capital to a positive level, specifies a minimum capital level that the bank must maintain, and provides a mechanism for funding future losses due to the financing risks the bank must take in fulfilling its mission. This is consistent with the position we have taken in the past in congressional testimony.

We are sending copies of this report to the Director of the Office of Management and Budget; the Secretary of the Treasury; the Chairmen of the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs; and the Board of Directors of the Export-Import Bank of the United States.

A handwritten signature in black ink, reading "Charles A. Bowsher". The signature is written in a cursive style with a large, prominent "C" and "B".

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviation

FFB Federal Financing Bank

**Comptroller General
of the United States**

B-197710

To the Board of Directors
Export-Import Bank of the United States

We have audited the accompanying statements of financial condition of the Export-Import Bank of the United States as of September 30, 1989 and 1988, and the related statements of income and changes in retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the bank's management. Our responsibility is to express an opinion on these financial statements based on our audits. In addition to this report on our audit of the bank's fiscal year 1989 and 1988 financial statements, we are reporting on our study and evaluation of the bank's internal control structure and compliance with laws and regulations.

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

In our report on the bank's fiscal year 1988 financial statements (GAO/AFMD-89-94), we expressed an opinion that those financial statements did not fairly present the bank's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles because of a material departure from such principles. Specifically, the bank did not report in its fiscal year 1988 financial statements an allowance for probable losses due to the uncollectibility of a portion of the outstanding balance of loans, claims, and accrued interest receivable. However, for the fiscal year ended September 30, 1989, the bank changed its policy and reported an allowance for loans and claims receivable losses of \$4.8 billion. Additionally, in fiscal year 1989, the bank ceased accruing interest on loans with delinquent payments over 90 days past due, and wrote off previously accrued interest on these loans. The bank's fiscal year 1988 financial statements have been restated to reflect the bank's change in reporting an allowance for loans and claims receivable losses and to conform with generally accepted accounting principles. The accounting change for accrued interest receivable was a change in an accounting estimate and recorded in fiscal year 1989 and not restated for prior years. The restatement of the 1988

financial statements resulted in an allowance for loans and claims receivable losses of \$3.7 billion as of September 30, 1988. Accordingly, our adverse opinion on the fiscal year 1988 financial statements has been changed.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Export-Import Bank of the United States as of September 30, 1989 and 1988, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The following section provides supplementary comments on the bank's overall financial condition and outlook, which we believe will assist the Congress in its oversight of the bank. The subsequent section explains the need for recapitalizing the bank. We continue to maintain the position we took in past testimony that recapitalization is necessary to ensure that the bank can effectively fulfill its mission in the future. In this section we also describe what we believe to be the essential elements of an effective recapitalization plan.

The Bank's Financial Condition and Outlook

The bank's mission, as outlined in the Export-Import Bank Act of 1945, as amended, is to aid in financing and facilitating exports and imports of goods and services between the United States and foreign countries and to promote and maintain American exports through fully competitive financing programs. The act requires the bank to gain reasonable assurance of repayment on loans. However, in carrying out its mission, the bank sometimes assumes levels of financing risk not generally borne by commercial banks. These risks have resulted in the bank incurring losses due to loan credit quality and interest rate subsidies.

To report the total costs of its various export financing programs, the bank must identify when assets have become impaired and their value reduced. In doing this, the bank must take into account all pertinent information about each borrower's financial condition and ability to repay as well as the effects of any change or deterioration in the economic and/or political conditions of the borrower's country. Such consideration of its entire portfolios of loans and claims receivable led the bank to formally announce on January 4, 1990, that it was establishing an allowance for losses of \$4.8 billion on its \$12.1 billion portfolio of loans and claims receivable for the fiscal year ended September 30, 1989. This allowance equals approximately 40 percent of the bank's loans and claims portfolios as of September 30, 1989. The allowance is

the bank's estimate of the probable losses it has sustained because of the impairment of its portfolios of loans and claims receivable.

In fiscal year 1989, the bank also reduced accrued interest receivable and interest income on loans by over \$271 million for repayment installments that were overdue by more than 90 days and for which there were no substantial efforts on the part of the borrowers to make payment. In the past, the bank had continued to accrue interest on a significant number of nonperforming loans for which collection was doubtful, resulting in an overstatement of interest income. Under this approach, the bank would have recognized approximately \$935 million in interest income on loans in fiscal year 1989. As a result of reducing previously accrued interest, the bank recognized \$664 million in interest income on loans in fiscal year 1989.

By disclosing an allowance for estimated losses on its loans and claims receivable portfolios and reversing its previously accrued interest on delinquent loans, the bank is more accurately reporting the costs of its export financing activities and the impact of these costs on its financial condition. Prior to restatement, the bank's fiscal year 1988 financial statements reflected an accumulated deficit of \$116 million, the first such deficit the bank ever reported. Restatement of the bank's fiscal year 1988 financial statements to account for the impairment of its foreign loans and claims receivable portfolios increased its reported deficit to \$3.4 billion. This change in the deficit indicates the extent to which the costs of the bank's programs had previously been understated. The prospects for collecting the bank's loans and claims receivable portfolios continued to deteriorate in fiscal year 1989, requiring the bank to report additional provisions for possible loan and claim losses totaling nearly \$1.1 billion. This contributed significantly to the \$1.9 billion net loss the bank incurred in fiscal year 1989 as well as further increasing the bank's accumulated deficit to approximately \$5.3 billion.

In addition to its credit quality problems, the bank is also experiencing a negative interest rate spread problem. In fulfilling its mission to promote and maintain American exports, the bank frequently lends money at lower interest rates than the rates at which it borrows from the Federal Financing Bank (FFB). As of September 30, 1989, the weighted average interest rate paid on the bank's \$11.0 billion FFB debt exceeded the weighted average interest rate received on loans in its loan portfolio by approximately 2.3 percent. This is an improvement of 2.1 percent from the negative interest rate spread of 4.4 percent that existed as of September 30, 1988.

However, based on the loans in the bank's loan portfolio at September 30, 1989, the interest rate paid on the FFB debt will continue to exceed the interest earnings rate on the current loan portfolio through fiscal year 1999. We estimate this negative interest rate spread will cost approximately \$821 million over the maturity period of the FFB debt. This estimate is based on the difference in the weighted average interest rates on the bank's loan portfolio and on its borrowings as of September 30, 1989, through the maturity date of the borrowings, which is fiscal year 1999.

As stated in our opinion on the bank's 1988 and 1987 financial statements, a one-time exposure fee that the bank began assessing in May 1987 to reduce the effects of negative spreads associated with new loans should diminish these effects, but the exposure fee will not improve the negative interest rate spread on most of the bank's current portfolio.

The effects of the negative interest rate spread and the continued impairment of the loans and claims receivable portfolios, as evidenced by the increasing levels of delinquencies and the sizable allowance for losses the bank has established, have adversely impacted the bank's cash and equity position. Cash and cash equivalents¹ decreased in both fiscal years 1989 and 1988, from an October 1, 1987, balance of \$694 million to a September 30, 1989, balance of \$72 million. Loan disbursements increased marginally over the 3-year period October 1, 1986, to September 30, 1989, while repayments on loans decreased substantially due to delinquencies, from \$3.6 billion in fiscal year 1987 to \$1.2 billion in fiscal year 1989.

The low level of loan repayments on the bank's loan portfolio as a result of the high level of delinquent loans and the negative interest rate spread of the bank has had an adverse effect on the bank's ability to repay its debt to FFB. As a result, all of the bank's loans from FFB that matured in 1989 had to be refinanced with new debt from FFB. If this trend continues in the future, not only will the bank be unable to retire the debt, it will also become increasingly dependent on FFB borrowings to pay its operating costs.

As of September 30, 1989, the bank's accumulated deficit equaled \$5.3 billion. As discussed in note 4, under the Export-Import Bank Act of

¹The bank defines cash equivalents as short-term, highly liquid investments with original maturities of 3 months or less. This definition would include all of the bank's investments in U.S. Treasury securities as of September 30, 1989 and 1988.

1945, as amended, the bank may have up to \$6 billion in loans outstanding at any one time with the Department of the Treasury. In addition, the bank has unlimited borrowing authority from FFB. Thus, the bank can continue to operate regardless of its losses and deficit. However, the bank is now at a point where it is unable to repay its outstanding FFB debt, as well as any additional borrowings needed to refinance its debt and continue operations. Such borrowings result in FFB or the Department of the Treasury financing the bank's losses.

The Need for a Comprehensive Recapitalization Plan

We stated in previous testimony² that we believe the Congress should implement a recapitalization plan for the Export-Import Bank. We continue to hold the position that an effective recapitalization plan should (1) restore the bank's equity position to a positive level as measured by generally accepted accounting principles and (2) provide a means for ensuring that the bank maintains a minimum positive level of capital despite any future losses it may incur in fulfilling its mission.

As we stated in previous testimony, there are a number of options for the recapitalization of the bank, including forgiving a portion of the bank's FFB debt or using appropriations or funds gained through capital stock sales to the Department of the Treasury to pay off the FFB debt. Maintaining the positive equity level resulting from recapitalization will require capital infusions in any fiscal year in which (1) additional provisions for possible loan and claim losses due to increased impairment of the bank's loan and claim portfolios and/or (2) the bank's losses associated with interest rate subsidies reduce the bank's capital below the specified minimum level.

Such a recapitalization plan has many benefits. First, and most importantly, it would allow the Congress to monitor the costs the bank incurs in performing its mission and to compare these costs with the benefits gained by expanding U.S. export markets. Second, maintaining a minimum capital level will increase the bank's international credibility. Third, ensuring that the bank operates successfully in the future will emphasize Congress's long-standing commitment to expanding U.S. export markets. Finally, an effective recapitalization plan will eliminate

²Recapitalizing the Export-Import Bank of the U.S.: Why It Is Necessary; How It Can Be Achieved (GAO/T-AFMD-88-4), statement of Frederick D. Wolf, Director, Accounting and Financial Management Division, before the Subcommittee on International Finance, Trade and Monetary Policy; Committee on Banking, Finance and Urban Affairs; House of Representatives; February 25, 1988.

the need for the bank to finance its annual losses with borrowings from FFB or Treasury.

A handwritten signature in black ink, reading "Charles A. Bowsher". The signature is written in a cursive style with a large, prominent "C" and "B".

Charles A. Bowsher
Comptroller General
of the United States

March 30, 1990

Report on Internal Control Structure

We have audited the financial statements of the Export-Import Bank of the United States for the years ended September 30, 1989 and 1988, and have issued our opinion thereon. This report pertains only to our study and evaluation of the bank's internal control structure for the year ended September 30, 1989. The report on our study and evaluation of the bank's internal control structure for the year ended September 30, 1988, is presented in GAO/AFMD-89-94, dated July 25, 1989.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

For purposes of this report, we have classified the bank's significant internal control structure policies and procedures into the following categories:

- expenditures, which consists of the policies and procedures associated with preparing and processing payroll and nonpayroll administrative expenses;

- financial reporting, which consists of the policies and procedures associated with processing accounting entries and preparing the bank's annual financial statements;
- insurance and guarantees, which consists of the policies and procedures associated with authorizing export insurance policies and guarantees, approving and paying insurance and guarantee claims, and recovering payments on insurance and guarantee claims;
- loans, which consists of the policies and procedures associated with authorizing and disbursing loans, accruing interest on loans, and collecting loan repayments; and
- treasury, which consists of the policies and procedures associated with disbursing and collecting cash, reconciling cash balances, investing cash, and managing debt.

For all of the internal control structure categories listed above, we obtained an understanding of the design of the relevant policies and procedures, determined whether they had been placed in operation, and assessed the associated control risk. We performed limited tests of control procedures for all the categories. In addition, we performed audit tests to substantiate account balances associated with each control category. Such tests can serve to identify weaknesses in the internal control structure.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. During our tests, however, we noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

We did note certain matters involving the internal control structure and its operations that do not affect the fair presentation of the bank's financial statements, but which nevertheless warrant management's attention. We are reporting these other matters separately to the bank's management.

Report on Compliance With Laws and Regulations

We have audited the financial statements of the Export-Import Bank of the United States for the years ended September 30, 1989 and 1988, and have issued our opinion thereon. This report pertains only to our review of the bank's compliance with laws and regulations for the year ended September 30, 1989. Our report on the bank's compliance with laws and regulations for the year ended September 30, 1988, is presented in GAO/AFMD-89-94, dated July 25, 1989.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the bank is responsible for compliance with laws and regulations applicable to the bank. As part of obtaining reasonable assurance as to whether the financial statements were free of material misstatement, we selected and tested transactions and records to determine the bank's compliance with certain provisions of the following laws and regulations which, if not complied with, could have a material effect on the bank's financial statements. However, it should be noted that our objective was not to provide an opinion on the overall compliance with such provisions.

We tested compliance with

- the Export-Import Bank Act of 1945 (12 U.S.C. 635 et seq.);
- the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1989 (Public Law 100-461, Title IV, 102 Stat. 2268-19-20);
- the Government Corporation Control Act; and
- the Prompt Payment Act (31 U.S.C. 3902, 3903, and 3905).

Because of the limited purpose for which our tests of compliance were made, the laws and regulations tested did not cover all legal requirements with which the bank has to comply.

The results of our tests for fiscal year 1989 indicate that, with respect to the items tested, the bank complied in all material respects with those provisions of laws and regulations that could have a material effect on the financial statements. With respect to transactions not tested, nothing came to our attention that caused us to believe that the bank had not complied, in all material respects, with those provisions.

Financial Statements

Statements of Financial Condition

(Dollars in Millions)

	As of September 30, 1989	1988 As Restated
ASSETS		
Cash and cash equivalents	\$ 72.0	\$ 92.7
Loans receivable, net (Note 2)	6,229.1	7,460.1
Claims receivable, net (Note 3)	1,113.2	1,295.6
Accrued interest and fees receivable	270.4	412.4
Other assets	10.6	9.3
Total assets	<u>\$ 7,695.3</u>	<u>\$ 9,270.1</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Borrowings (Note 4)	\$10,983.6	\$10,957.6
Claims payable (Note 3)	812.0	428.1
Accrued interest payable	98.7	101.1
Other liabilities	26.7	48.2
Total liabilities	<u>11,921.0</u>	<u>11,535.0</u>
Commitments and contingencies (Note 9)		
Capital stock held by U.S. Treasury	1,000.0	1,000.0
Unexpended appropriations (Note 8)	72.9	85.1
Accumulated deficit	(5,298.6)	(3,350.0)
Total stockholders equity	<u>(4,225.7)</u>	<u>(2,264.9)</u>
Total liabilities and stockholders equity	<u>\$ 7,695.3</u>	<u>\$ 9,270.1</u>

See accompanying notes.

Statements of Income and Changes in Retained Earnings

(Dollars in Millions)		For the year ended September 30,	
		1989	1988 As Restated
Interest income			
Interest on loans	\$ 663.7	\$ 807.3	
Interest on investments	15.3	40.2	
Total interest income	<u>679.0</u>	<u>847.5</u>	
Interest expense			
Interest on borrowings	1,262.6	1,353.5	
Other interest expense (Note 6)	9.6	6.9	
Total interest expense	<u>1,272.2</u>	<u>1,360.4</u>	
Net interest income	(593.2)	(512.9)	
Provision for possible losses on loans (Note 2)	718.9	256.4	
Provision for possible losses on claims (Note 3)	<u>368.3</u>	<u>132.6</u>	
Net Interest Income after provisions for losses	(1,680.4)	(901.9)	
Non-interest income			
Commitment fees	9.2	9.3	
Exposure fees	6.1	8.6	
Insurance premiums and guarantee fees	46.7	49.0	
Other income	.8	.9	
Total non-interest income	<u>62.8</u>	<u>67.8</u>	
Non-interest expense			
Administrative expenses	20.0	19.4	
Claim loss expenses (recoveries)	293.8	(38.0)	
Other expenses	<u>17.2</u>	<u>32.4</u>	
Total non-interest expense	<u>331.0</u>	<u>13.8</u>	
Net loss	(1,948.6)	(847.9)	
Accumulated deficit - beginning of the year, as previously reported	(116.4)	311.8	
Adjustment to reflect cumulative effect of prior period adjustments	-	<u>(2,813.9)</u>	
Accumulated deficit - beginning of the year, as restated	<u>(3,350.0)</u>	<u>(2,502.1)</u>	
Accumulated deficit - end of the year	<u>\$(5,298.6)</u>	<u>\$(3,350.0)</u>	

See accompanying notes.

Statements of Cash Flows

(Dollars in Millions)		For the year ended September 30,	
		1989	1988
			As Restated
CASH FLOWS FROM OPERATIONS			
Net loss		\$(1,948.6)	\$ (847.9)
Adjustments to reconcile net loss to net cash provided:			
Amortization of unexpended appropriations	(.7)	(.7)	(.7)
Provision for possible losses on loans	718.9	256.4	256.4
Provision for possible losses on claims	368.3	132.6	132.6
	(862.1)	(459.6)	(459.6)
Increase in claims receivable, excluding allowance for possible losses	(185.9)	(168.7)	(168.7)
Decrease in accrued interest and fees receivable	142.0	176.1	176.1
Decrease (increase) in other assets	(1.3)	64.9	64.9
Increase (decrease) in claims payable	383.9	(22.9)	(22.9)
Decrease in accrued interest payable	(2.4)	(12.5)	(12.5)
Increase (decrease) in other liabilities	(21.5)	9.2	9.2
Net cash from operations	(547.3)	(413.5)	(413.5)
CASH FLOWS FROM INVESTING ACTIVITIES			
Loan disbursements	(686.1)	(511.6)	(511.6)
Repayments of loans receivable	1,198.1	1,821.7	1,821.7
Net cash from investing activities	512.0	1,310.1	1,310.1
CASH FLOWS FROM FINANCING ACTIVITIES			
Repayments of Federal Financing Bank Borrowings	(1,079.0)	(1,688.8)	(1,688.8)
Borrowings from the Federal Financing Bank	1,105.0	183.0	183.0
Unexpended appropriations receipts (disbursements)	(11.4)	7.6	7.6
Net cash from financing activities	14.6	(1,498.2)	(1,498.2)
Net decrease in cash and cash equivalents	(20.7)	(601.6)	(601.6)
Cash and cash equivalents - beginning of the year	92.7	694.3	694.3
Cash and cash equivalents - end of the year	<u>\$ 72.0</u>	<u>\$ 92.7</u>	<u>\$ 92.7</u>
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for interest (net of amount capitalized)	\$ 1,274.6	\$ 1,354.1	\$ 1,354.1
See accompanying notes.			

Notes to Financial Statements

1. Summary of Significant Accounting and Reporting PoliciesEnabling Legislation and Statutory Limitations

The Export-Import Bank of the United States (Eximbank) is an independent corporate agency of the United States, which was first organized as a District of Columbia banking corporation in 1934. The primary legislation governing its operations consists of the Export-Import Bank Act of 1945, as amended, and the Government Corporation Control Act.

Under the Export-Import Bank Act the Bank is limited to \$40 billion of loans, guarantees and insurance outstanding at any one time. Guarantees and insurance are charged against the \$40 billion limitation at not less than 25 percent of Eximbank's contractual liability, with the provision that the aggregate amount of guarantees and insurance so charged may not exceed \$25 billion outstanding at any one time. Thus, Eximbank's contractual commitments outstanding at any one time could reach \$58.75 billion, consisting of \$25 billion of guarantees and insurance outstanding, resulting in a \$6.25 billion charge against the \$40 billion limitation, and \$33.75 billion (additional commitments) charged at 100 percent against the limitation.

Statements of Cash Flow

In November 1987, the Financial Accounting Standards Board issued Statement No. 95, "Statement of Cash Flows" (SFAS 95). The Bank elected to adopt the provisions of SFAS 95 for fiscal year 1988 by presenting the Statements of Cash Flow in place of the Statement of Changes in Financial Position. For purposes of implementing SFAS 95, the Bank defined cash equivalents as short-term highly liquid investments with original maturities of three months or less. This definition includes all of the Bank's investments in U.S. Treasury securities at September 30, 1989 and 1988.

Accrued Interest on Loans Receivable

Interest is accrued on loans as it is earned. Loans receivable delinquent 90 days or more are placed in a nonaccrual status unless they are well secured and significant collections have been received during the past year. Any accrued but unpaid interest previously recorded on loans placed in a non-accrual status is reversed against current period interest income.

Accounting for Capitalized Interest
on Rescheduled Loans

Frequently, terms of rescheduling agreements require that previously accrued interest be added to the loan receivable balance (capitalized). When this occurs for loans in a non-accrual status, the accrued interest to be capitalized is credited to income at the time the interest is capitalized. Any reduction in income and in the receivable value which should be recorded for such capitalized interest is included in the provision and allowance for possible loan losses, respectively.

Allowance for Possible Loan and
Claim Losses

Eximbank recorded allowances for loan and claim receivable losses for the first time in fiscal year 1989. The allowance for possible loan and claim receivable losses provides for the risk of loss inherent in the lending process. Providing for such losses does not imply that any loans or claims will be written off. It recognizes the fact that the prospects of collection of some of the Bank's loans and claims are sufficiently far into the future that the value of the loans and claims receivable are impaired. The allowance is a general allowance available to absorb loan and claim losses related to the total loan and claim portfolios. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries.

The establishment of an allowance for possible loan and claim receivable losses for fiscal year 1989 was a change in accounting principle. In accordance with the provisions of Accounting Principles Board Opinion No. 20, the fiscal year 1988 financial statements have been restated to reflect the change. The effect of this change was to increase the fiscal year 1988 net loss from its previously reported level of \$460.9 million to \$847.9 million as reported in the fiscal year 1988 comparative financial statements as restated.

Loan Fees

The Bank adopted effective October 1, 1988, the provisions of Statement of Financial Accounting Standards No. 91 "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases" (SFAS 91). As a result, the risk related exposure fee charged on loan disbursements is recognized as an adjustment to the yield over the life of the loan.

Commitment fees on Eximbank's direct loans, which are generally nonrefundable, are calculated and recognized monthly based on the commitment fee rate multiplied by the undisbursed loan balance outstanding.

Guarantee and Insurance Fees

Fees under guarantee and insurance policies are deferred when collected and recorded in a liability account. Deferred fees are recognized as income on a straight line basis over the life of the guarantee and insurance policies.

Claims Payable

Liabilities for claims arising from the bank's guarantee and insurance activities, and the related estimated losses and loss adjustment expenses, are accrued based on historical and anticipated loss experience.

Reclassifications

The Bank has reclassified the presentation of certain fiscal year 1988 information to conform with the fiscal year 1989 presentation format.

2. Loans Receivable

The Bank extends medium-term and long-term direct loans to foreign buyers of U.S. exports and intermediary loans to fund responsible parties that extend loans to foreign buyers. Loans extended under the medium-term loan program have repayment terms of one to seven years, while loans extended under the long-term loan program have repayment terms in excess of seven years. Both the medium-term and long-term loans cover up to 85 percent of the U.S. export value of shipped goods. The Bank's direct loans carry the lowest fixed interest rate permitted for the country and term under the "Arrangement on Guidelines for Officially Supported Export Credits" negotiated among members of the Organization for Economic Cooperation and Development (OECD). For intermediary loans, financing institutions engaged in the business of making export loans to buyers of U.S. exports and unrelated to the exporter may borrow from the Bank at less than the OECD interest rate to permit the lender to charge the fixed OECD rate to the foreign buyer and retain an interest spread for handling the transaction.

The Bank's loans receivable as shown in the Statement of Financial Condition are net of an allowance for possible loan losses. At September 30, 1989 and 1988, the allowance for possible loan losses equaled 33.6 percent and 24.7 percent, respectively, of the total outstanding loans receivable balance. The balance of loans receivable, net, at September 30, 1989 and 1988 consists of the following (in millions):

Financial Statements

	September 30,	
	1989	1988
Total Loans	\$9,381.9	\$9,905.3
Less: Allowance for possible loan losses	<u>3,152.8</u>	<u>2,445.2</u>
Loans Receivable-net	<u>\$6,229.1</u>	<u>\$7,460.1</u>

The changes that occurred to the allowance for loan losses for fiscal years 1989 and 1988 are as follows (in millions):

	September 30,	
	1989	1988
Balance, as previously reported	\$ -	\$ -
Adjustment for restatement	-	2,190.6
Balance at beginning of year	<u>2,445.2</u>	<u>2,190.6</u>
Provision charged to expense	718.9	256.4
Charge-Offs	(16.8)	(5.2)
Less: Recoveries	<u>5.5</u>	<u>3.4</u>
Balance at end of year	<u>\$3,152.8</u>	<u>\$2,445.2</u>

The provision for possible loan losses is based on the Bank's evaluation of the loan portfolio taking into consideration a variety of factors, including repayment status of loans, assessment of future risks, and worldwide economic and political conditions.

From time to time Eximbank extends the repayment date and modifies the interest terms of some or all principal installments of a loan because the obligor or country has encountered financial difficulty and Directors of the Bank have determined that providing relief in this manner will enhance the ability to collect the loan. The outstanding balances related to rescheduled installments included in loans receivable as of September 30, 1989 and 1988 were \$4,201.6 million and \$3,893.6 million, respectively. The rescheduled loan installments of principal and interest for fiscal year 1989 were \$250.9 million and \$161.0 million, respectively, and for fiscal year 1988 were \$202.9 million and \$138.0 million, respectively. The interest rate on rescheduled loans is generally a floating rate of interest which is 37.5 to 50.0 basis points over the Bank's cost of funds.

The amount of undisbursed commitments to debtors having rescheduled debt outstanding was \$349.8 million and \$138.7 million as of September 30, 1989 and 1988, respectively.

3. Claims Receivable

Claims receivable represent the outstanding balance of claims paid or pending payment which were submitted to the Bank in its

capacity as guarantor and insurer under the Bank's export guarantee and insurance programs. Also included in claims receivable is the Bank's estimate of expected recoveries on claims for guaranteed or insured events which have been or will be incurred but have not been reported to the Bank (IBNR). Estimated IBNR recoveries are equal to 100 percent of the Bank's estimated IBNR liability, which is included in claims payable.

The Bank's claims receivable as shown in the Statement of Financial Condition are net of an allowance for possible claim losses. At September 30, 1989 and 1988, the allowance for possible claim losses equaled 59.6 percent and 49.6 percent, respectively, of the total outstanding claims receivable balance. The balance of claims receivable, net, at September 30, 1989 and 1988 consists of the following (in millions):

	September 30,	
	1989	1988
Claims previously paid and unrecovered:		
Rescheduled	\$1,232.3	\$1,295.2
Non-rescheduled	710.4	845.5
Claims filed pending payment	531.0	158.0
Incurred but not reported (IBNR) estimated recoveries	<u>281.0</u>	<u>270.1</u>
Claims receivable	\$2,754.7	\$2,568.8
Less: Allowance for possible claim losses	<u>1,641.5</u>	<u>1,273.2</u>
Claims Receivable, net	<u>\$1,113.2</u>	<u>\$1,295.6</u>

The changes that occurred to the allowance for possible claim losses for fiscal years 1989 and 1988 are as follows (in millions):

	September 30,	
	1989	1988
Balance, as previously reported	\$ -	\$ -
Adjustment for restatement	-	1,140.6
Balance at beginning of year	<u>1,273.2</u>	<u>1,140.6</u>
Provision charged to expense	<u>368.3</u>	<u>132.6</u>
Balance at end of year	<u>\$1,641.5</u>	<u>\$1,273.2</u>

The provision for possible claim losses is based on the Bank's evaluation of claims receivable taking into consideration a variety of factors, including repayment status of the claims, assessment of future risks, and worldwide economic and political conditions. The Bank, based on management's judgement, includes in its allowance

for possible claim losses an allowance for IBNR estimated recoveries equal to 50 percent of the IBNR estimated receivable.

4. Borrowings

As of September 30, 1989, 70.7 percent of the Bank's \$10,983.6 million long-term debt owed to the Federal Financing Bank (FFB), has maturity dates within the next five years as indicated below (dollars in millions):

<u>Fiscal Years of Maturities</u>	<u>Amount Maturing</u>	<u>Weighted Average Rate on Maturities</u>
1989	\$ -	11.31%
1990	1,638.8	11.30
1991	1,281.9	11.06
1992	1,433.5	10.68
1993	1,713.9	10.57
1994	<u>1,694.2</u>	9.61
	7,762.3	
1995 - 1999	<u>3,221.3</u>	
	<u>\$10,983.6</u>	

FFB borrowings, with an outstanding balance of \$7,578.1 million as of September 30, 1989, include a provision for prepayment penalties. The remaining borrowings of \$3,405.5 million as of September 30, 1989, have note terms that state the notes may be prepaid without penalty upon consent of FFB and Treasury. However, Treasury has not consented to prepayments without penalty. The penalty amount is equal to the difference between the present value of the future cash payments of the debt based on its contractual terms and the present value of the debt payments computed using the then current FFB lending rate.

Eximbank has authority under its authorizing legislation to borrow directly from the U.S. Treasury and to have up to \$6 billion of such borrowings outstanding. The Bank avails itself of this authority for its short-term needs on a daily basis at a 91-day Treasury bill rate. Excess cash is also used to reduce these borrowings on a daily basis. The bank did not have borrowings outstanding owed to Treasury at September 30, 1989 and 1988.

5. Interest Subsidies

In fulfilling its mission to aid in financing and facilitating exports of U.S. goods and services to foreign countries and to provide U.S. exporters with financing which is competitive with that provided by foreign governments to their exporters, the Bank

frequently lends money at interest rates lower than its cost of borrowings. This results in a negative interest rate spread between the Bank's loans and its borrowings.

The weighted average interest rate for the Bank's foreign loan portfolio at September 30, 1989, equaled 8.92 percent, while the weighted average interest rate on the Bank's FFB borrowings equaled 11.31 percent, resulting in a negative interest rate spread of 2.39 percent. The cost associated with the negative interest rate spread at September 30, 1989, which is appropriately not reflected in these financial statements, is estimated to be approximately \$821 million based on the maturity period of the FFB debt.

6. Related Party Transactions

The Bank's statements reflect the results of contractual agreements with the Foreign Credit Insurance Association (FCIA), and with the Private Export Funding Corporation (PEFCO).

FCIA is an association of primary insurance companies. Eximbank issues export credit insurance in cooperation with FCIA. Under a contractual agreement, Eximbank reinsures all of the commercial risks and, in addition, insures all political risks, covers any operational expenses in excess of premiums, and has a majority on the FCIA Board of Directors. Under the contractual agreement with Eximbank, FCIA markets and administers the insurance policies, including billing and collecting premiums, processing and paying claims, and pursuing recovery on claims.

Premiums written and earned by FCIA for fiscal years 1989 and 1988 were \$8.4 million and \$13.3 million, respectively, for commercial risks, and \$18.0 million and \$15.2 million, respectively, for political risks, for a total of \$26.4 million and \$28.5 million. FCIA's general and administrative expenses were \$12.5 million and \$12.4 million for those years. Premium revenues, net of expenses, are ceded to Eximbank. Eximbank recognizes the net premium revenues generated by the insurance program over the life of the insurance policies. The net amounts that are due from FCIA to Eximbank as of September 30, 1989 and 1988 were \$4.5 million and \$3.3 million, respectively. These receivables are included in other assets.

PEFCO is an organization owned by private sector banks and industrial companies which makes fixed interest rate loans to foreign borrowers when such loans are not available from traditional private sector lenders on competitive terms. PEFCO has agreements with Eximbank which, for specified fees, provide that Eximbank will (1) guarantee the due and punctual payment of principal and interest on all export loans made by PEFCO, (2) guarantee the due and punctual payment of interest on PEFCO long-term debt obligations when requested by PEFCO, (3) hold a \$50 million short-term revolving credit line at the disposal of PEFCO,

(4) protect PEFCO against movements in interest rates adversely affecting the spread between PEFCO's fixed rate loan commitments to borrowers and the eventual cost of funding such commitments (PEFCO has waived such protection with respect to all fixed rate loan commitments heretofore made and which may be made through September 30, 1990), and (5) retain a broad measure of supervision over PEFCO's major financial management decisions.

In a separate agreement consummated in fiscal year 1980, Eximbank and PEFCO agreed to share in providing a total of \$1,350 million of U.S. export financing at fixed rates of interest. Eximbank's share of the total was \$251 million and PEFCO's share was \$1,099 million. Eximbank serviced PEFCO's share of these loans for PEFCO, and guaranteed PEFCO's contractual interest rate on these loans. The rate charged by PEFCO and guaranteed by Eximbank includes a return to PEFCO of 0.35 percent. Eximbank disbursed funds under the total loan commitment to the borrowers, including PEFCO's portion, and was subsequently reimbursed by PEFCO. The Bank recorded disbursements for PEFCO's portion of the loan commitments in a receivable account included in other assets and reduced this account when reimbursements were received from PEFCO. PEFCO reimbursed Eximbank \$97.0 million in August 1988 for the final disbursement made under this agreement. When Eximbank receives a payment related to these loans from the debtor, it remits PEFCO's portion of the payment on the date it is received. Should interest received on the loan be less than interest due PEFCO under the terms of the guarantee, Eximbank charges its other interest expense for the shortfall. During fiscal year 1989, \$8.9 million of the Bank's \$9.6 million charged to other interest expense was attributable to loans covered under this guarantee agreement. In comparison, in fiscal year 1988, \$6.2 million of the Bank's \$6.9 million charged to other interest expense was due to loans covered under the guarantee agreement.

7. Pensions and Accrued Annual Leave

Virtually all of Eximbank's employees are covered by either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For CSRS employees, Eximbank withholds a portion of their base earnings. Their contribution is then matched by Eximbank and the sum is transferred to the Civil Service Retirement Fund, from which the CSRS employees will receive retirement benefits. For FERS employees, Eximbank withholds, in addition to social security withholdings, a portion of their base earnings. Eximbank contributes an amount proportional to their base earnings toward retirement, and in addition a scaled amount toward each individual FERS Employee's Thrift Savings Plan, depending upon his/her level of savings. The FERS employees will receive retirement benefits from the Federal Employees Retirement System, Social Security System and, from the Thrift Savings Plan, deposits that have accumulated in their accounts.

Total Eximbank (employer) matching contributions to the Civil Service Retirement System and Federal Employees Retirement System for all employees, included in administrative expenses, were approximately \$1,044,000 and \$938,000 for fiscal years ended September 30, 1989 and 1988, respectively.

Although Eximbank funds a portion of pension benefits under the Civil Service and Federal employees Retirement System relating to its employees and makes the necessary payroll withholdings from them, Eximbank does not account for the assets of the Civil Service and Federal Employees Retirement Systems nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management for the Retirement Systems and are not allocated to the individual employers. The Office of Personnel Management also accounts for all health and life insurance programs for retired federal employees.

Eximbank's liability to employees for accrued annual leave, included in other liabilities, was \$1,056,000 at September 30, 1989 and \$950,000 at September 30, 1988.

8. Appropriations from the U.S. Treasury

For fiscal year 1988, Congress authorized an appropriation of up to \$110 million for a "War Chest" for the purpose of making grants and to reimburse the Bank for interest rate subsidies in connection with loans made available by the Bank to support U.S. export sales, with the proviso that any authorization of "War Chest" funds would reduce the amount available to the Bank in fiscal year 1988 for authorizing new loans. Of the \$110 million, \$7.6 million in appropriated funds was received by the Bank in fiscal year 1988.

As of September 30, 1988, the balance of unexpended "War Chest" appropriations from fiscal year 1988 and prior years was \$85.0 million. During fiscal year 1989, disbursements of \$11.4 million for grants were made from these funds. In addition, \$0.7 million representing the difference between the Bank's standard interest rate and the lower rate authorized for some loans as a grant equivalent, was credited to income. This reduced the balance of unexpended appropriations to \$72.9 million as of September 30, 1989. Of this balance, \$36.2 million is specifically available for future grant disbursements and \$36.7 million is specifically available to reimburse the Bank for interest rate subsidies in connection with the five loans under the program with authorized interest rates which are lower than the Bank's standard interest rate. The Bank had \$60.0 million outstanding on total commitments of \$139.1 million at September 30, 1989, for the five loans with interest rate subsidies as a grant equivalent.

For fiscal year 1989, Eximbank was authorized to receive "War Chest" appropriations up to \$110 million, however, since no War Chest grants were authorized by the bank in fiscal year 1989, none of the fiscal year 1989 appropriation was received.

9. Commitments and Contingencies

At September 30, 1989, Eximbank's outstanding receivables, guarantees and insurance, and their impact on the Bank's statutory limits (see Note 1) for such purposes are as follows (dollars in millions):

	<u>Amount Outstanding</u>	<u>Statutory Authority Used</u>
Outstanding Loans	\$ 9,381.9	\$ 9,381.9
Undisbursed Loans	1,925.0	1,925.0
Estimated Recoveries on Disbursed Claims	1,942.7	1,942.7
Guarantees	5,381.1	1,345.3
Insurance	<u>8,190.8</u>	<u>2,047.7</u>
Committed Balance	<u>\$26,821.5</u>	<u>\$16,642.6</u>

Limitations on the amount of loans, and guarantees and insurance which may be committed by Eximbank in any given year are established each year by legislation enacted by Congress. For fiscal year 1989, Eximbank's loan limitation was \$718.8 million. Guarantee and insurance authorization limitations were \$17,901.0 million. Actual fiscal year 1989 loan authorizations were \$718.8 million. Guarantee and insurance authorizations were \$5,602.5 million. For fiscal year 1988, Eximbank was limited to \$692.9 million of new loan authorizations and war chest grants, and \$13,405.5 million of new guarantee and insurance commitments. Eximbank authorized \$685.3 million of loans and \$7.6 million in war chest grants, and authorized \$5,734.6 million of guarantees and insurance in fiscal year 1988.

Since its inception, Eximbank's Charter has been periodically renewed by Congress. The Charter currently expires on September 30, 1992.

The Bank has no capital leases. Operating lease arrangements are renewable annually. These leases consist primarily of rental of the office space and EDP equipment. Office space is leased from General Services Administration through the Public Buildings Fund. The lease expenses, included in administrative expenses, were \$2.4 million and \$2.5 million for fiscal years 1989 and 1988, respectively.

As of the end of fiscal year 1989, the Bank was named in several legal actions, virtually all involving claims under the guarantee and insurance programs. Currently, it is not possible to predict the eventual outcome of the various actions. However, it is management's opinion that these claims will not result in liabilities to such an extent that they will materially affect the Bank's financial position.

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