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REPORT TO THE CONGRESS

Examination Of Financial Statements Of The National Flood Insurance Program Fiscal Year 1972

B 114860

Federal Insurance Administration
Department of Housing and Urban
Development

B-114860

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

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JULY 25, 1973



COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate the
Speaker of the House of Representatives

We have examined the financial statements of the National Flood Insurance Program, Federal Insurance Administration, Department of Housing and Urban Development, for the fiscal year ended June 30, 1972.

We made our examination pursuant to the Government Corporation Control Act (31 U.S.C. 841).

We are sending copies of this report to the Director, Office of Management and Budget, the Secretaries of the Treasury and Housing and Urban Development, and the Administrator, Federal Insurance Administration.

James B. Stacks

Comptroller General
of the United States

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ABBREVIATIONS

FIA	Federal Insurance Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
NFIA	National Flood Insurers Association

D I G E S T

WHY THE EXAMINATION WAS MADE

The National Flood Insurance Act subjected the National Flood Insurance Program to the Government Corporation Control Act. As a result, GAO is required to examine the program's financial statements annually.

The National Flood Insurance Program is a two-part operation:

- 1 The Federal Insurance Administration, a component of the Department of Housing and Urban Development (HUD),
 - sets policy,
 - establishes premium rates,
 - designates areas eligible for insurance, and
 - reinsures, for a fee, the insurers that sell flood insurance (See pp 3 to 8)
- 2 The National Flood Insurers Association, a pool of 99 private insurance companies participating in the program under an agreement with the Secretary of Housing and Urban Development, conducts day-to-day insurance activities, such as selling insurance, collecting premiums, and settling claims (See p 9)

GAO examined the program's financial statements in accordance with generally accepted auditing standards and included tests of the accounting records and other procedures considered necessary.

OPINION ON FINANCIAL STATEMENTS

National Flood Insurance Program
Federal Insurance Administration

In GAO's opinion, the accompanying financial statements (schs 1 through 3) present fairly the National Flood Insurance Program's financial position at June 30, 1972, and the results of its operations, and the sources and application of its funds for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws (See p 12)

National Flood Insurers Association

The Association's balance sheets (app II), the statements of income and residual balance (app III), and the statements of changes in financial position (app IV) for the fiscal year ended June 30, 1972, omit the estimated liability of \$880,000 for Federal income taxes and the related effects that presentation of the liability would have on the financial statements. In GAO's opinion, the financial statements of

the Association, except for the omission of the liability for Federal income taxes, present fairly the Association's financial position at June 30, 1972, and the results of its operation and changes in financial position for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State or regulatory authorities, applied on a consistent basis (See p 15)

Concerning the Association's financial statements for fiscal year 1971 (apps II through IV), GAO's report dated October 11, 1972, on the Examination of Financial Statements of the National Flood Insurance Program, fiscal year 1971, stated that, because of the materiality of the amount of Federal income taxes, GAO was of the opinion that the Association's financial statements did not present fairly the financial position of the Association at June 30, 1971, or the results of its operations for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State regulatory authorities, applied on a consistent basis (See p 15)

RECOMMENDATIONS OR SUGGESTIONS

This report contains no recommendations or suggestions

AGENCY COMMENTS

The Association disagreed with GAO's opinion on its financial statements and stated that it had reason to be optimistic that a decision would be forthcoming, indicating that the Association would not incur an annual tax liability. The Association's public accountant did not furnish GAO with written comments but agreed with the comments furnished by the Association.

The Association did not dispute the fact that it did not have tax-exempt status at June 30, 1972--a prerequisite for not showing the tax liability in the financial statements. Accordingly, GAO's opinion on the financial statements is appropriate.

HUD agreed with GAO's opinion that the Association should have recorded the liability for Federal income taxes in its financial statements as of June 30, 1972.

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report provides the Congress with the results of GAO's examination of the financial statements of the National Flood Insurance Program and other information concerning the program's operations and financial condition.

CHAPTER 1

INTRODUCTION

The National Flood Insurance Program was established under authority of the National Flood Insurance Act of 1968 (42 U.S.C. 4011). The act included a provision subjecting the program to the Government Corporation Control Act and thus made mandatory an annual audit by the Comptroller General. The 1968 act authorized the Secretary of Housing and Urban Development to establish and carry out a national flood insurance program and to encourage and assist insurance companies and other insurers to join together in a pool to provide flood insurance coverage to property owners in flood-prone areas. The act extended the term "flood" to include inundation from mudslides caused by accumulation of water on or under the ground

The Secretary delegated the administration of the program to the Administrator, Federal Insurance Administration (FIA), a Department of Housing and Urban Development (HUD) component which also administers programs that provide crime insurance and reinsurance against abnormal loss resulting from riots and civil commotion.

The National Flood Insurance Program is a subsidized Government-sponsored program designed to enable owners of real or personal property, in areas designated by the Administrator, FIA, as eligible for flood insurance, to purchase such insurance. Premium rates are established on an actuarial basis and, insofar as practicable, at a level sufficient to cover the estimated full cost of the insurance and to enable the accumulation of reserves to pay anticipated losses. To encourage the purchase of flood insurance, the Administrator can establish lower than full-cost rates--chargeable rates. The difference between the chargeable rates and the full-cost actuarial rates provides the basis for subsidy by the Federal Government.

The Secretary entered into an agreement with the National Flood Insurers Association (NFIA) to provide insurance coverage on a limited risk-sharing basis. (See p. 9.) The agreement describes NFIA as a voluntary, nonprofit, unincorporated association. At June 30, 1972, NFIA consisted of 99 private insurers

The 1968 act authorized the Secretary to borrow up to \$250 million from the U.S. Treasury on interest-bearing notes or other obligations to establish a National Flood Insurance Fund. Credits to the fund, in addition to borrowings from the Treasury, consist of (1) reinsurance premiums, (2) advances from appropriations to maintain the fund in an operative condition adequate to meet its liabilities, (3) interest earned on investments of the fund, (4) transfers from NFIA of the amount by which its operating balance for any accounting period exceeds 5 percent of policyholder premiums (to be held by the Administrator, FIA, for payment of losses, operating costs, and operating allowances NFIA may sustain in the future), and (5) any other receipts accruing from the insurance operations.

The fund is available for (1) premium equalization payments to insurers (based on the difference between the actuarially determined, full-cost premium rates and the chargeable premium rates established by the Administrator, FIA, to encourage the purchase of flood insurance), (2) payment of claims of insurers which purchased reinsurance coverage from FIA to cover excess flood insurance losses (to be computed on the basis of an established formula), (3) financing of the flood insurance program, in whole or in part, in the event that the joint Government-industry operation becomes unfeasible, (4) repayment to the Treasury of amounts borrowed together with interest, (5) payment of such administrative expenses as the Secretary may deem necessary to carry out the flood insurance program, and (6) payment of incurred losses, operating costs, and operating allowances to NFIA (not exceeding the balance of funds previously paid to the Administrator, FIA, to be held for this purpose).

The 1968 act authorized the Secretary to study and investigate flood-prone areas to obtain information on the adequacy of State and local measures for land management and use, flood control, flood zoning, and flood damage prevention. The act directed the Secretary to use the information to develop comprehensive criteria designed to encourage, if necessary, the adoption of adequate State and local measures which, to the maximum extent feasible, would (1) lessen the exposure of property and facilities to flood losses, (2) improve the long-range land management and use of land in flood-prone areas, and (3) inhibit the unplanned and economically unjustifiable future development of land in flood-prone areas.

The act authorized also the appropriation of funds for administrative expenses necessary to carry out the National Flood Insurance Program, including costs incurred in studies and investigations to establish premium rates and for those expenses necessary to determine the areas eligible for flood insurance.

The Housing and Urban Development Act of 1969 (42 U.S.C. 4056) amended the 1968 act to provide for an emergency flood insurance program for a 2-year period ended December 31, 1971, during which time the Secretary was authorized to provide flood insurance coverage at the Government-subsidized chargeable rate without first determining actuarial premium rates for individual areas. In December 1971 the 1968 act was further amended to extend the emergency insurance program to December 31, 1973.

NFIA began to sell regular program flood insurance on June 25, 1969, after the Secretary had designated the first two communities eligible for flood insurance coverage. At June 30, 1972, 1,174 communities were eligible for flood insurance coverage, 391 under the regular program and 783 under the emergency program. Regarding the future availability of regular program flood insurance, the 1968 act, as amended, provided that, after December 31, 1971, flood insurance coverage would be available only in States or areas which had adopted adequate land use and control measures, consistent with the comprehensive criteria prescribed by the Secretary. During fiscal year 1972, the eligibility of 30 communities was suspended because of failure to comply with these criteria and three communities voluntarily left the flood insurance program. Of the suspended communities, seven were reinstated during fiscal year 1972. The 1968 act limited to \$2.5 billion the amount of flood insurance that might be in force at any given time. Public Law 93-4 dated February 2, 1973, increased the limit to \$4 billion. At June 30, 1972, about \$1.5 billion of flood insurance was in force.

CHAPTER 2

DESCRIPTION OF INSURANCE COVERAGE

GENERAL INFORMATION

The owner of real or personal property insured under the National Flood Insurance Program is indemnified for loss of, or damage to, his property resulting from naturally caused general floods or mudslides and for damage from other than natural causes, such as the breaking of a dam. However, the insurance does not cover loss from water or mudslide damage resulting from causes on an owner's property or from conditions within his control.

Flood insurance policies are written for 1-year terms under both the regular and the emergency programs. When the Administrator, FIA, designates an area as eligible for flood insurance, NFIA designates a member company office as the servicing office for the eligible area. NFIA pays servicing offices on a sliding scale based upon volume handled. In turn, FIA reimburses NFIA at a rate of \$10 per policy. According to NFIA records the average fee paid to servicing offices for processing a policy during fiscal year 1972 was \$10.85.

During fiscal year 1972, NFIA paid the agent securing the business a commission of 15 percent of the annual premium. To stimulate the sale of flood insurance, the commission arrangement was revised, effective July 10, 1972, to provide for payment of \$10 or 15 percent of the annual premium, whichever is greater, to the agent securing the business, for each policy written.

An insurance policy is effective as of the date of an application, if the application is submitted within 30 days after an area has been designated as eligible for insurance. Thereafter, a policy becomes effective 15 days after submission of an application for insurance. The full annual premium is payable at the time the application is made. The policy is renewable on the anniversary date, upon payment of the annual premium. A clause included in each policy specifies a deductible of \$200 for loss on a structure and \$200 for loss on the contents of a structure, or 2 percent of the amount of each loss, whichever is greater.

PREMIUMS

The Administrator, FIA, must establish actuarial rates for each community before it is eligible for flood insurance coverage under the regular program. He is authorized to carry out studies and investigations to obtain the information necessary to estimate these rates which are to be based on accepted actuarial principles, taking into consideration the risk involved and including applicable operating costs and allowances and certain administrative expenses.

The Administrator, FIA, is also authorized to prescribe chargeable premium rates to make flood insurance available, where necessary, at reasonable rates so as to encourage the purchase of flood insurance.

The chargeable premium rates are based on the value of the insured property, and during fiscal year 1972, the rates for structural coverage ranged from \$0.40 to \$0.50 per \$100 of insurance coverage for residential structures and from \$0.50 to \$0.70 per \$100 of insurance coverage for non-residential structures. The chargeable premium rates for coverage of contents of residential structures ranged from \$0.50 to \$0.60 per \$100 of insurance coverage and for contents of nonresidential structures was \$1 per \$100 of insurance coverage.

Effective July 10, 1972, the Administrator, FIA, to further encourage the purchase of flood insurance reduced the chargeable premium rates. The reduced rates range from \$0.25 to \$0.35 per \$100 of insurance coverage for residential structures and from \$0.40 to \$0.60 per \$100 of insurance coverage for nonresidential structures. The new rates for coverage of contents are \$0.35 to \$0.45 per \$100 of insurance coverage of contents of residential structures and \$0.75 per \$100 of insurance coverage of contents of nonresidential structures.

REGULAR PROGRAM

At June 30, 1972, insurance coverage under the regular program was available for all structures, including buildings (1) used for residential, business, agricultural, or religious purposes, (2) occupied by private nonprofit organizations, and (3) owned by State or local governments. Coverage was also available for the contents of these buildings.

The limits on insurance coverage available were \$35,000 for single-family residential structures, \$60,000 for all other structures, and \$10,000 for the contents of each unit used for residential purposes and \$10,000 contents coverage per occupant of nonresidential structures

The annual premium for structures in existence before an area is eligible for insurance under the regular program is the lower of the actuarial or the chargeable rate for the first half of the insurance coverage available plus the actuarial rate for the remaining half. The actuarial rate is charged for all coverage on structures constructed in an area after it has been identified by the Secretary as having special flood or mudslide hazards

Under the regular program 53,748 policies with coverage amounting to \$696.9 million were in force at June 30, 1972

EMERGENCY PROGRAM

At June 30, 1972, insurance coverage under the emergency program was available for all structures, including buildings (1) used for residential, business, agricultural, or religious purposes, (2) occupied by private nonprofit organizations, and (3) owned by State or local governments. Coverage was also available for the contents of these buildings

The limits on insurance coverage available for the foregoing structures were half of the coverage available under the regular program, or \$17,500 for single-family residential structures, \$30,000 for all other structures, and \$5,000 for the contents of each residential unit and \$5,000 coverage for contents per occupant of nonresidential structures.

All premiums under the emergency program are at the chargeable premium rates, and 41,375 policies with coverage amounting to \$838.2 million were in force at June 30, 1972

CHAPTER 3

AGREEMENT WITH NATIONAL FLOOD INSURERS ASSOCIATION

The 1968 act authorized the Secretary to encourage and assist insurance companies to join together in a pool to (1) provide flood insurance coverage, (2) participate financially in underwriting the risks assumed, and (3) adjust and pay claims for flood losses. Pursuant to this authorization, the Secretary entered into an agreement with NFIA, which described NFIA as a voluntary, nonprofit, unincorporated association of insurers. The agreement was effective for the accounting period June 6, 1969, through June 30, 1970, and is considered to have been renewed annually unless otherwise agreed to or terminated. The agreement was renewed through June 30, 1973. The more significant terms of the agreement follow

1. NFIA will exercise its best efforts to provide a continuous program of flood insurance, and changes in its membership shall not affect the continuity of the program
2. Flood insurance in force at any one time shall not exceed \$2 5 billion face amount, and NFIA shall provide a minimum of \$40 million in risk capital subscribed to by its member companies at inception of the first accounting period. (Public Law 93-4 dated February 2, 1973, increased to \$4 billion the amount of flood insurance in force at any one time.)
3. NFIA shall arrange for the issuance of policies as well as for investigation, adjustment, and settlement of all claims presented under the policies.
4. NFIA shall purchase excess loss reinsurance coverage from the National Flood Insurance Program. Premium payments shall be made quarterly at a provisional rate of 6 percent of the policyholders' premiums applicable to the quarter. The total premiums paid at the provisional rate shall be adjusted at the conclusion of the accounting period to an amount computed by the application of agreed-upon inland and coastal rates to the policyholders' premiums emanating from insurance in force in the inland and

costal areas Claims for excess-loss reinsurance coverage shall be paid by the National Flood Insurance Program when the total of incurred losses and operating costs for any accounting period after deducting premium equalization payments exceeds 125 percent of policyholder premiums.

- 5 NFIA may retain as an operating allowance, for such uses as its constitution may permit, a part of operating profit earned in an accounting period in an amount not to exceed 5 percent of the policyholder premiums applicable to the period. Operating profit in excess of 5 percent of the policyholder premiums shall be paid to the Administrator, FIA, to be held in the Treasury of the United States for the payment of future NFIA losses, operating costs, and operating allowances. Pending payment to the Administrator, the funds shall be invested in obligations of or fully guaranteed by the United States. Any such funds remaining at the termination of this agreement shall, after the payment of all obligations incurred for the most recent accounting period, be paid into the National Flood Insurance Fund
- 6 If in any accounting period NFIA does not earn an amount equal to 5 percent of policyholder premiums applicable to that period, it is entitled to payment from the funds previously paid to the Administrator in an amount sufficient to provide NFIA with an operating balance equal to 5 percent of policyholder premiums applicable to that period, provided that the payment does not exceed the balance of the fund then being held by the Administrator.
- 7 The National Flood Insurance Program, using a formula set forth in the agreement to compute the amount, shall make periodic premium equalization payments to NFIA for the Government's share of flood insurance claims paid and for equalization of operating costs.

CHAPTER 4

SCOPE OF EXAMINATION

Our examination of FIA's financial statements pertaining to the National Flood Insurance Program for the fiscal year ended June 30, 1972, was made in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances

HUD's Office of Washington Operations and Special Projects, Office of Inspector General, did not examine the National Flood Insurance Program's accounting records pertaining to fiscal year 1972 operations, therefore, no internal audit work was available to enable us to reduce our tests of the program's accounting records

NFIA activities are an integral part of the National Flood Insurance Program and are subject to GAO audit pursuant to the Government Corporation Control Act. NFIA engaged a firm of public accountants to audit its financial statements. Our audit included observations and tests of the firm's work

CHAPTER 5

OPINION ON THE FINANCIAL STATEMENTS

NATIONAL FLOOD INSURANCE PROGRAM

HUD prepared the financial statements of the National Flood Insurance Program, presented as schedules 1 through 3

In our opinion, these financial statements present fairly the National Flood Insurance Program's financial position at June 30, 1972, and the results of its operations and the source and application of funds for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

NATIONAL FLOOD INSURERS ASSOCIATION

The financial statements of NFIA are presented as appendixes II through V. The certified public accountants engaged by NFIA stated, in their opinion (see app I), that

"The Association has applied for a ruling from the Internal Revenue Service requesting that the income of the Association not be subject to Federal income taxation. To date, the Association has not received such ruling. If National Flood Insurers Association were to be deemed a taxable organization and taxed on a basis similar to that which currently applies to fire and casualty insurance companies, the resulting tax would have a material impact on its results of operations for the fiscal years ended June 30, 1972 and 1971 and on its financial position as of such dates as reflected in the accompanying financial statements.

"In our opinion, subject to the ultimate determination of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of National Flood Insurers Association at June 30, 1972 and 1971 and the results of its operations and changes in financial position.

for the fiscal years then ended, in conformity with accounting principles prescribed or permitted for insurance companies by state regulatory authorities, applied on a consistent basis."

In our opinion, NFIA had a liability for Federal income taxes at June 30, 1972 and 1971, and the impact of the liability should have been presented in the financial statements for the fiscal years then ended

We based our opinion on a ruling by the Internal Revenue Service (Rev Rule 60-144, 1960-1 CB636) which states that, until determination of a tax-exempt status, a proper income tax return (or a request for an extension of time to file a return) must be filed and payment of tax made, which will be refunded if the organization is found to be exempt. In the circumstances, NFIA's nonpayment of the Federal income taxes created a tax liability at June 30, 1972 and 1971. As of June 30, 1973, the Internal Revenue Service had not ruled on NFIA's tax status

We estimated that NFIA's liability for Federal income taxes at June 30, 1971, amounted to about \$1.1 million after giving effect to the net loss of \$92,442.44 incurred in fiscal year 1970 operations. Determining the tax liability at June 30, 1972, required recomputation of the \$1.1 million computed for the fiscal year ended June 30, 1971, in order to give effect to the net loss of \$526,350.05 before provision for Federal income taxes (app III) incurred in fiscal year 1972 operations. On the basis of our recomputation, we estimate that NFIA's total liability for Federal income taxes at June 30, 1972, except for penalties and interest, if any, amounted to about \$880,000

Recognizing the \$880,000 liability for Federal income taxes at June 30, 1972, would reduce the balance of operating profits below the amount that NFIA is entitled to retain under the terms of an agreement which became effective in fiscal year 1972. The agreement provides that NFIA is required to transfer to the Administrator the portion of the operating profit that exceeds 5 percent of policyholder premiums applicable to the period. The agreement provides also that, if in any accounting period NFIA does not earn an amount equal to 5 percent of policyholder premiums, NFIA

is entitled to payments from funds previously paid to the Administrator in an amount sufficient to provide NFIA with an operating balance equal to 5 percent of policyholder premiums applicable to that period, provided that the payment does not exceed the balance of the fund then being held by the Administrator (See items 5 and 6, p 10)

As a result of recognizing the liability for Federal income taxes, the liability to HUD of \$673,301 (app II) would be eliminated and NFIA would be entitled to a payment of \$206,699 from HUD to restore the balance of operating profits to an amount equal to 5 percent of policyholder premiums for the periods concerned

The adjustments necessitated by recognizing the liability for Federal income taxes require the following revisions to the financial statements for fiscal years 1971 and 1972

In the financial statements for fiscal year 1971, the total liabilities would be shown in appendix II as \$4.5 million instead of \$3.4 million and the total residual balance would be \$1.36 million instead of \$2.46 million. Also, the net income in appendix III would be shown as \$1.37 million instead of \$2.47 million, because of the \$1.1 million reduction to provide for the Federal income taxes. In addition, the net income in appendix IV would be shown as \$1.37 million instead of \$2.47 million and \$1.1 million for Federal income taxes would be added to the "Noncash charges and credits."

In the financial statements for fiscal year 1972, the liability for Federal income taxes in appendix II would be shown as \$880,000 and the liability to HUD of \$673,301 would be eliminated. A receivable of \$206,699 would be included to show the payment due from HUD to restore NFIA's operating balance to an amount equal to 5 percent of policyholder premiums. As a result of the foregoing changes, the total liabilities for fiscal year 1972 would be shown in appendix II as \$12.6 million and the total other assets as \$4.6 million. In appendix III the net loss of \$526,350 would be reduced to \$306,350 after giving effect to the adjustment of \$220,000 in the provision for Federal income taxes. In addition, the operating balance of \$673,301 shown in the residual balance section as being "Due HUD" would be changed to show \$206,699 as being "Due from HUD." In appendix IV (1) the net loss would be shown as \$306,350 instead of \$526,350,

(2) "Accounts and expenses due or accrued" would be shown as \$190,266 instead of \$863,567, (3) an amount of \$220,000 for the reduction in liability in Federal income taxes would be added to the "Noncash charges and credits," and (4) the \$673,301 shown as "Transferred to operating balance due HUD" would be deleted

In our opinion, the financial statements of NFIA (apps II through IV), except for the omission of the estimated liability for Federal income taxes, present fairly NFIA's financial position on June 30, 1972, and the results of its operations and changes in financial position for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State or regulatory authorities, applied on a consistent basis

In regard to NFIA's financial statements for fiscal year 1971 (apps. II through IV), our report dated October 11, 1972, on the "Examination of Financial Statements of the National Flood Insurance Program," fiscal year 1971, states that, because of the materiality of the amount of the Federal income taxes, we are of the opinion that NFIA's financial statements do not present fairly the financial position of NFIA at June 30, 1971, or the results of its operations for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State regulatory authorities, applied on a consistent basis

CHAPTER 6

AGENCY COMMENTS

In commenting on our draft report, NFIA disagreed with our opinion on its financial statements. The Association indicated that it had reason to be optimistic that a decision would be forthcoming, indicating that NFIA would not incur an annual tax liability.

Although Lybrand, Ross Bros & Montgomery did not furnish us with written comments, it informed us that it agreed with the comments furnished by NFIA.

We evaluated the comments submitted to us by NFIA and considered that NFIA did not have a tax-exempt status at June 30, 1972, and the effect on the NFIA financial statements of not showing the liability for Federal income taxes and the related tax expense. NFIA did not dispute the fact that it did not have tax-exempt status at June 30, 1972--a prerequisite, in our opinion, for not showing the tax liability in the financial statements. Accordingly, our opinion on the financial statements of NFIA expressed on page 15 is appropriate.

HUD agrees with our opinion that NFIA should have recorded the liability for Federal income taxes in its financial statements as of June 30, 1972.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FEDERAL INSURANCE ADMINISTRATION
NATIONAL FLOOD INSURANCE PROGRAM
COMBINED BALANCE SHEET

June 30 1972

ASSETS

	<u>National Flood Insurance Fund</u>	<u>Appropriated Funds</u>	<u>Total</u>
Cash and Fund Balances			
On deposit with U S Treasury	\$ -	\$ 5,213,104 42	\$ 5,213,104 42
Accounts Receivable			
Reinsurance premiums from NFIA	453,918 64	-	453,918 64
Trust deposit from NFIA	673,301 32	-	673,301 32
	<u>\$ 1,127,219,96</u>	<u>\$ 5,213,104 42</u>	<u>\$ 6,340,324,38</u>

LIABILITIES

Accounts Payable			
Studies and surveys - Government	\$ -	\$ 2,527 001 52	\$ 2 527,001 52
Studies and surveys - Other		120 346 90	120 346 90
Equalization payments due NFIA	4,042 136 32	-	4,042 136 32
Accrued interest payable	71 741 50		71,741 50
Trust and deposit liabilities	1,160,581 09		1,160,581 09
	<u>5,274,458.91</u>	<u>2,647,348 42</u>	<u>7,921,807 33</u>

INVESTMENT OF THE U S GOVERNMENT

Notes payable to the U S Treasury	2,832,115 67	-	2,832,115 67
Congressional appropriations (net of \$911,695 89 returned to the U S Treasury)	-	14,016,804 11	14,016,804 11
Cumulative deficit (-)	-6,979,354.62	-11,451,048.11	-18,430,402 73
Investment of U S Government (impairment-)	-4,147,238 95	2,565,756 00	-1,581,482,95
	<u>\$ 1,127,219,96</u>	<u>\$ 5,213,104,42</u>	<u>\$ 6,340,324 38</u>

The notes on page 20 are an integral part of this statement

SCHEDULE 2

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
 FEDERAL INSURANCE ADMINISTRATION
 NATIONAL FLOOD INSURANCE PROGRAM
 COMBINED STATEMENT OF INCOME AND EXPENSE AND CUMULATIVE DEFICIT
 FOR FISCAL YEAR ENDED JUNE 30, 1972

	<u>National Flood Insurance Fund</u>	<u>Appropriated Funds</u>	<u>Total</u>
Income			
Reinsurance premiums	<u>\$1,055,708.35</u>	<u>\$ -</u>	<u>\$ 1,055,708.35</u>
Total income	<u>1,055,708.35</u>	<u>-</u>	<u>1,055,708.35</u>
Expense			
Interest expense	104,804.57	-	104,804.57
Premium equalization payments	7,094,418.55	-	7,094,418.55
Administrative expense	-	657,000.00	657,000.00
Studies and surveys expenses	<u>-</u>	<u>5,839,543.46</u>	<u>5,839,543.46</u>
Total expense	<u>7,199,223.12</u>	<u>6,496,543.46</u>	<u>13,695,766.58</u>
Net loss for the fiscal year	6,143,514.77	6,496,543.46	12,640,058.23
Deficit at June 30, 1971	<u>835,839.85</u>	<u>4,954,504.65</u>	<u>5,790,344.50</u>
Cumulative deficit at June 30, 1972	<u>\$6,979,354.62</u>	<u>\$11,451,048.11</u>	<u>\$18,430,402.73</u>

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
 FEDERAL INSURANCE ADMINISTRATION
 NATIONAL FLOOD INSURANCE PROGRAM
 COMBINED STATEMENT OF SOURCE AND APPLICATION OF FUNDS
 (COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION)
 FOR FISCAL YEAR ENDED JUNE 30, 1972

	<u>National Flood Insurance Fund</u>	<u>Appropriated Funds</u>	<u>Total</u>
Source of Funds			
Borrowing from U S Treasury	\$1,771,782 27	\$ -	\$ 1,771,782 27
Congressional appropriations	-	6,000,000 00	6,000,000 00
Reinsurance premiums	1,055,708 35	-	1,055,708 35
Decrease in working capital	<u>4,371,732.50</u>	<u>514,146.75</u>	<u>4,885,879 25</u>
Total source of funds	<u>\$7,199,223.12</u>	<u>\$6,514,146 75</u>	<u>\$13,713,369 87</u>
Application of Funds			
Congressional appropriations returned to U S Treasury	\$ -	\$ 17 603 29	\$ 17,603 29
Interest expense	104 804 57	-	104,804 57
Premium equalization payments	7,094,418 55	-	7,094,418 55
Administrative expense	-	657,000 00	657,000 00
Studies and surveys expenses	<u>-</u>	<u>5,839,543 46</u>	<u>5,839,543.46</u>
Total application of funds	<u>\$7,199,223 12</u>	<u>\$6,514,146 75</u>	<u>\$13,713,369 87</u>

NOTES TO COMBINED BALANCE SHEET

June 30, 1972

Effective as of July 1, 1971, the agreement between the Secretary and NFIA was amended to provide for the payment to the Administrator of that portion of NFIA's operating balance which in any accounting period exceeds 5 percent of the policyholder premiums. The agreement specifies that the amount paid is to be held in the Treasury of the United States for the payment of future losses, operating costs and operating allowances as allowed by the Administrator. The Administrator and NFIA agreed that computation of the amount due to or from NFIA would be on the basis of a policy participation year. On this basis insurance premiums are considered income in the year that the policies become effective, and losses and expenses related to the policies are deducted from the income, regardless of the year incurred or paid. The balance of \$673,301.32 shown in Schedule 1 as an account receivable due from NFIA was computed on the basis of the following policy participation year data:

<u>Participation year ending June 30</u>	<u>Participation year operating balance or (loss)</u>	<u>5% of policy holder premiums^a</u>	<u>Amount due FIA or (due NFIA)^a</u>
1971	\$ 3,712,901.34	\$278,490.15	\$ 3,434,411.19
1972	(2,340,527.73)	354,829.95	(2,695,357.68)
1973	<u>(55,799.74)</u>	<u>9,952.45</u>	<u>(65,752.19)</u>
	<u>\$ 1,316,573.87</u>	<u>\$643,272.55</u>	<u>\$ 673,301.32</u>

^aThe contract provides that if in any accounting period NFIA incurs an operating loss or does not earn a profit equal to 5 percent of policyholder premiums, it is entitled to payment from the funds previously paid to the Administrator, FIA, in an amount (not to exceed the balance of such funds) sufficient to provide NFIA with an operating balance equal to 5 percent of policyholder premiums.

Because losses and expenses are not all incurred or paid by the end of a participation year, the operating balance for the participation year cannot be determined for at least one year thereafter. As a result, the figures shown in the foregoing table are preliminary amounts subject to adjustment by the results of activities occurring after June 30, 1972, including payment, if any, of Federal income taxes.

As of June 30, 1972, the National Flood Insurance Program was contingently liable for (1) its share of flood insurance losses (equalization losses) that the National Flood Insurers Association may pay on the insurance in force at June 30, 1972, in the event of a flood and (2) its share of the costs that may be incurred by the National Flood Insurers Association to settle the flood insurance loss claims in connection with the insurance in force at June 30, 1972. The amount of the contingent liability is not readily ascertainable since flood losses, if any, will be contingent upon the occurrence, extent, and severity of floods in the areas covered by flood insurance.

The National Flood Insurers Association purchased excess loss insurance from the National Flood Insurance Program. As of June 30, 1972, the National Flood Insurance Program is contingently liable for excess losses that the National Flood Insurers Association may incur for the insurance in force at June 30, 1972. The amount of the contingent liability is not readily ascertainable since it is contingent upon the occurrence, extent, and severity of floods in the areas covered by flood insurance. The method for computing the amount of excess loss is provided in the agreement between National Flood Insurers Association and the Secretary of HUD.

LYBRAND ROSS BROS & MONTGOMERY
CERTIFIED PUBLIC ACCOUNTANTS

COOPERS & LYBRAND
IN PRINCIPAL AREAS
OF THE WORLD

AUDITORS' REPORT

To the Executive Committee
National Flood Insurers Association
New York, N Y

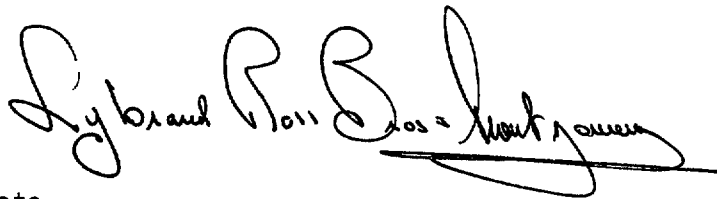
We have examined the accompanying balance sheets of National Flood Insurers Association as of June 30, 1972 and 1971 and the related statements of income and residual balance and changes in financial position for the fiscal years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The Association maintains its accounts in conformity with accounting principles prescribed by state insurance regulatory authorities. These principles are at variance with generally accepted accounting principles as explained in Note 1 of the Notes to Financial Statements.

The Association has applied for a ruling from the Internal Revenue Service requesting that the income of the Association not be subject to Federal income taxation. To date, the Association has not received such ruling. If National Flood Insurers Association were to be deemed a taxable organization and taxed on a basis similar to that which currently applies to fire and casualty insurance companies, the resulting tax would have a material impact on its results of operations for the fiscal years ended June 30, 1972 and 1971 and on its financial position as of such dates as reflected in the accompanying financial statements.

APPENDIX I

In our opinion, subject to the ultimate determination of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of National Flood Insurers Association at June 30, 1972 and 1971 and the results of its operations and changes in financial position for the fiscal years then ended, in conformity with accounting principles prescribed or permitted for insurance companies by state regulatory authorities, applied on a consistent basis

A handwritten signature in cursive script, appearing to read "Seymour B. Ross". The signature is written in dark ink and is positioned to the right of the date text.

New York, October 25, 1972
(except as to Note 6, the date
of which is December 20, 1972)

NATIONAL FLOOD INSURERS ASSOCIATION
BALANCE SHEETS, June 30, 1972 and 1971

ADMITTED ASSETS	<u>1972</u>	<u>1971</u>
Cash and investments		
Cash in bank and office		
In office awaiting deposit	\$ 184,061 90	\$ 91,445 82
Demand deposits	529,035 11	398,923 68
Time deposits	1,600,000 00	1,600,000 00
	<u>2,313,097 01</u>	<u>2,090,369 50</u>
Investments (at amortized cost)		
Treasury bills	3,420,554 15	2,778,889 65
Bankers acceptances	1,406,291 59	292,400 00
Other	1,653,210 29	
	<u>6,480,056 03</u>	<u>3,071,289 65</u>
Total cash and investments	<u>8,793,153 04</u>	<u>5,161,659 15</u>
Other assets		
Premium balances	289,855 00	214,780 00
Accrued interest	30,016 23	16,071 17
Equalization operating costs		
receivable and accrued - due from		
United States Government, Department		
of Housing and Urban Development	4,042,136 32	416,050 61
Other assets	553 71	44,778 00
Total other assets	<u>4,362,561 26</u>	<u>691,679 78</u>
	<u>\$13,155,714 30</u>	<u>\$5,853,338 93</u>
 LIABILITIES and RESIDUAL BALANCE		
Liabilities		
Losses (Note 3)	\$ 6,914,058 00	\$ 42,300 00
Loss adjustment expenses (Note 3)	829,686 00	5,000 00
Unearned premiums	2,835,183 00	2,319,109 00
Federal income tax (Note 2)		
Operating balance due H U D (Note 4)	673,301 32	
Accounts and expenses due or accrued		
Service fees	174,389 00	357,795 00
Loss drafts payable	313,018 92	5,301 02
Reinsurance premiums	453,918 64	613,927 26
Other liabilities	104,111 20	52,100 64
Unallocated claim expenses	40,131 47	1,745 37
Premium taxes (Note 1)	91,342 20	
Total liabilities	<u>12,429,139 75</u>	<u>3,397,278 29</u>
Residual balance		
Membership fees	83,302 00	83,202 00
Undistributed income (operating		
allowances) (Note 4)	643,272 55	2,372,858 64
Total residual balance	<u>726,574 55</u>	<u>2,456,060 64</u>
	<u>\$13,155,714.30</u>	<u>\$5,853,338.93</u>

The accompanying notes are an integral
part of these financial statements

APPENDIX III

STATEMENTS of INCOME and RESIDUAL BALANCE
for the fiscal years ended June 30, 1972 and 1971

	<u>1972</u>	<u>1971</u>
Income		
Gross premiums written	\$ 7,003,383 00	\$5,882,687 00
Less, Reinsurance premiums	<u>1,055,707 70</u>	<u>858,490 76</u>
Net premiums written	5,947,675 30	5,024,196 24
Change in unearned premium reserve	<u>516,074 00</u>	<u>1,687,973 00</u>
Net premiums earned	5,431,601 30	3,336,223 24
Investment income earned	<u>291,403 71</u>	<u>133,572 25</u>
Total income	<u>5,723,005 01</u>	<u>3,469,795 49</u>
Expenses		
Commissions	<u>1,095,360 50</u>	<u>837,579 13</u>
Equalization operating costs		
Service fees	1,003,727 40	1,129,664 80
General expenses	393,453 36	249,510 66
Losses	9,434,564 40	293,618 15
Loss expenses	<u>1,136,532 63</u>	<u>42,164 50</u>
	11,968,277 79	1,714,958 11
Less, Recovered from United States Government, Department of Housing and Urban Development	<u>7,094,418 55</u>	<u>1,548,042 83</u>
	4,873,859 24	166,915 28
Premium taxes (Note 1)	<u>280,135 32</u>	<u>-0-</u>
Net expenses	<u>6,249,355 06</u>	<u>1,004,494 41</u>
Income (loss) before taxes	(526,350 05)	2,465,301 08
Federal income tax (Note 2)		
Net income (loss)	<u>(526,350 05)</u>	<u>2,465,301 08</u>
Residual balance (Note 4)		
Residual balance (deficit), beginning of year	2,456,060 64	(9,440 44)
Membership fees received	100 00	200 00
Membership - residual balance distribution - participation year 1970	(42,654 95)	
H U D - residual balance distribution - participation year 1970	(487,279 77)	
Transferred to operating balance due H U D	<u>(673,301 32)</u>	
Residual balance, end of year	<u>\$ 726,574 55</u>	<u>\$2,456,060 64</u>

The accompanying notes are an integral part of these financial statements

STATEMENTS of CHANGES in FINANCIAL POSITION
for the fiscal years ended June 30, 1972 and 1971

	<u>1972</u>	<u>1971</u>
Source of Funds		
Net income (loss)	(\$ 526,350 05)	\$2,465,301 08
Noncash charges and credits		
Premium balances	(75,075 00)	175,545 10
Accruals and prepayments	(3,640,030 77)	(324,402 84)
Unearned premiums	516,074 00	1,687,973 00
Losses and loss adjustment expense reserves	7,696,444 00	47,300 00
Accounts and expenses due or accrued	<u>863,567 75</u>	<u>713,436 95</u>
Membership fees received	4,834,629 93	4,765,153.29
	<u>100 00</u>	<u>200 00</u>
Total	<u>4,834,729 93</u>	<u>4,765,353 29</u>
Application of Funds		
Increase in investments, net		
Treasury bills	641,664 50	2,752,912 95
Bankers acceptances	1,113,891 59	292,162.50
Other	<u>1,653,210 29</u>	<u> </u>
Distribution to membership (residual balance)	3,408,766 38	3,045,075 45
Distribution to H U D (residual balance)	42,654 95	
Transferred to operating balance due H U D	487,279 77	
	<u>673,301 32</u>	<u> </u>
Total	<u>4,612,002 42</u>	<u>3,045,075 45</u>
Increase in cash balances	222,727 51	1,720,277.84
Cash balance, beginning of year	<u>2,090,369 50</u>	<u>370,091 66</u>
Cash balance, end of year	<u>\$2,313,097.01</u>	<u>\$2,090,369 50</u>

The accompanying notes are an integral
part of these financial statements

APPENDIX V

NOTES to FINANCIAL STATEMENTS

1 Basis of Presentation

National Flood Insurers Association (also referred to as the "Association" or "NFIA" in these notes) is a voluntary, unincorporated association of insurers, which began operations on June 6, 1969, pursuant to the National Flood Insurance Act of 1968

The accompanying financial statements have been prepared, except as to form, in accordance with the requirements of the Insurance Department of the State of New York which include the immediate charge to income of the cost of acquiring new business while the related premium income is deferred over the periods covered by the policies. The effect of this variance from generally accepted accounting principles has not been determined.

During fiscal 1972, the Association has incurred premium taxes directly. In prior years such taxes were covered by the service fees charged the Association by the service carriers.

2 Federal Income Taxes

The Association has applied for a ruling from the Internal Revenue Service requesting that the income of NFIA not be subject to Federal taxation. To date, the Association has not received a ruling. Counsel for NFIA is of the opinion, however, that a ruling will be issued granting NFIA the request.

Should the Association be denied the request and its taxable income computed on a basis similar to that currently applicable to fire and casualty insurance companies, the resulting income tax would have a material impact on the Association's operating results for the fiscal years ended June 30, 1972 and 1971 and its financial position as of those dates as reflected in the accompanying financial statements.

3 Loss Reserves

The estimated liability for losses and loss adjustment expenses is necessarily based on estimates and no representation is made that the ultimate liability may not exceed such estimates. The estimates are reviewed continuously during the year and changes therein are reflected in operating results currently.

4 Residual Balance

Pursuant to an agreement between the Association and the Secretary of Housing and Urban Development (H U D), restrictions are applicable to the disposition of positive operating balances (profits) resulting from NFIA's operations. Among others, such restrictions limit to 5% of each year's policyholders premiums the amounts of profits which may be retained.

Continued

NOTES to FINANCIAL STATEMENTS, Continued

and used by the Association in accordance with the terms of its constitution. Amounts in excess of the aforementioned limitation are to be paid to H U D and held in the Treasury of the United States for the payment of future incurred losses and operating costs and allowances.

The operating balance due H U D, established in accordance with the above-mentioned agreement in effect at June 30, 1972, is analyzed as follows:

	<u>Operating Balance*</u>	<u>Less, Operating Allowance*</u>	<u>Operating Balance Due H U D **</u>
Participation year ending June 30			
1971	\$3,712,901 34	\$278,490 15	\$3,434,411 19
1972	(2,340,527 73)	354,829 95	(2,695,357 68)
1973	<u>(55,799 74)</u>	<u>9,952 45</u>	<u>(65,752 19)</u>
Total all years	<u>\$1,316,573 87</u>	<u>\$643,272 55</u>	<u>\$ 673,301 32</u>

*If for any accounting period the Association's operating balance is not sufficient to cover an operating allowance (equal to 5% of policyholders premiums), funds previously paid to or held in trust for H U D shall be available therefor. Reference is here made to Note 6.

**See Note 2 with respect to a Federal income tax ruling and its possible material effect on calculations shown in the above table. Payments to H U D have been suspended pending resolution of this matter.

5 Commitments and Contingencies

The Association is a party to an agreement with the Secretary of Housing and Urban Development. The agreement provides, among other matters, for reinsurance on an excess of loss basis of the business underwritten by NFIA, and places certain restrictions on the profits which inure to the benefit of the Association's member insurance companies (see Note 4). This agreement may be terminated by either party upon written notice to the other on or before January 31 of any accounting period, and termination, should it eventuate, becomes effective at the end of the Association's accounting period (June 30).

Continued

NOTES to FINANCIAL STATEMENTS, Continued

NFIA has also entered into a service agreement with Insurance Services Office (ISO) whereby the latter performs the necessary administrative functions for the former, subject to the overall direction of the NFIA Executive Committee. The services under this agreement are billed to the Association at ISO's cost. The agreement may be cancelled by either party on sixty days written notice, or at any time by mutual consent.

Reference is here made to Note 2 in respect of Federal income taxes.

- 6 Events Subsequent to Date of Auditors' Report
Operating results for the participation year ended June 30, 1971 have been closed and on December 19, 1972 the Association's Executive Committee approved the distribution to member companies for such year in the approximate amount of \$278,000.

PRINCIPAL OFFICIALS OF
 THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
 AND THE FEDERAL INSURANCE ADMINISTRATION
 RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES
 DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF HOUSING AND URBAN DEVELOPMENT		
James T Lynn	Feb 1973	Present
George W. Romney	Jan 1969	Jan 1973
ADMINISTRATOR, FEDERAL INSURANCE ADMINISTRATION		
George K Bernstein	May 1969	Present

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