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

CIVIL DIVISION

MAR 31 1972

Dear Mr. Hamil:

We have reviewed the policies and practices of the Rural Electrification Administration (REA) for advancing funds to borrowers to finance the construction, improvement, and operation of electric and telephone facilities which serve rural residents. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Our review--made at REA headquarters and the offices of 21 selected borrowers in nine States--included an examination of records relating to advances of about \$155 million to the 21 borrowers during the period February 1, 1968, to June 30, 1971. Funds advanced by REA to all borrowers during this period totaled about \$1.7 billion.

Our review showed that contrary to the Government policy that cash advances be timed to be in accord with a borrower's actual cash requirements, REA's practice has been to advance funds to borrowers without sufficient consideration of the borrowers' cash requirements. Also REA's instructions are contrary to the Government policy that cash advances be made monthly or more frequently to meet borrowers' current disbursement needs, and do not provide for the use of letters of credit for borrowers who receive advances totaling \$250,000 or more annually. As a result, Government funds have been disbursed in advance of the time the funds were actually needed by the borrowers thus accelerating Government borrowings and increasing related interest costs.

On the basis of our review of the records for the 21 selected borrowers, we estimated that the Government could have realized interest savings of about \$467,000 if REA had advanced the funds to the 21 borrowers only as needed.

We are recommending that REA

- revise its instructions to require that advances be made monthly or more frequently to meet borrowers' current disbursement needs,
- establish a program for systematically monitoring the advance of funds to borrowers to provide assurance that advances are made in accordance with the borrowers' actual needs, and

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--establish policies and procedures governing the use of letters of credit for borrowers who receive advances totaling \$250,000 or more annually.

The enclosure to this letter describes our findings and recommendations in detail. We will be pleased to discuss these matters with you or members of your staff if you desire. Also, we will appreciate receiving your comments and advice as to the particular actions you plan to take with respect to our recommendations.

We wish to acknowledge the cooperation extended to our representatives during the review. Copies of this report are being furnished to the Inspector General, Department of Agriculture.

Sincerely yours,

Richard J. Woods
Richard J. Woods
Assistant Director

Enclosure

Mr. David A. Hamil, Administrator
Rural Electrification Administration
Department of Agriculture

REVIEW OF RURAL ELECTRIFICATION
ADMINISTRATION POLICIES AND PRACTICES FOR
ADVANCING LOAN FUNDS TO BORROWERS

INTRODUCTION

The Rural Electrification Administration (REA), Department of Agriculture, is authorized under sections 4 and 201 of the Rural Electrification Act of 1936 (7 U.S.C. 901-24) to make direct loans at an interest rate of 2 percent per annum to public and nonpublic organizations to finance the construction, improvement, and operation of central station electric and telephone systems which primarily serve rural residents.

REA is also authorized under section 5 of the act to make loans to finance the wiring of premises of persons in rural areas and the acquisition and installation of electrical and plumbing appliances and equipment. Such loans may be made to any of the borrowers of funds loaned under section 4 of the act or to any person, firm, or corporation supplying or installing the said wiring, appliances, or equipment.

REA advances to borrowers normally include funds for costs incurred and for costs that will be incurred. The portion of an REA advance for costs incurred is generally made on the basis of work orders for work or services completed and expenses incurred and paid from the borrower's own funds. The portion of an advance for costs that will be incurred is generally made on the basis of estimates of (1) payments that will become due on REA-approved contracts, or (2) other expenses, such as overhead, materials, or labor, that will be incurred for purposes approved by REA.

As required by the loan contract, borrowers are to deposit advances in a special construction fund account and the advances are to be disbursed only for the purposes for which their use was approved. Borrowers are required to establish these accounts in the banks of their choice under deposit agreements entered into by the borrowers and the banks.

REA loans are financed with Treasury borrowings. The Congress appropriates funds yearly but, if any part of the funds appropriated are not loaned or obligated during that fiscal year, they can be loaned in the following year or years. All repayments of loan principal and interest received by REA are returned to the Treasury.

SAVINGS AVAILABLE BY TIMING ADVANCES OF
FUNDS WITH ACTUAL CASH REQUIREMENTS

Contrary to Government policy, REA's practice has been to advance funds to borrowers under its electric and telephone loan programs without sufficient consideration of the borrowers' cash requirements. Also REA's instructions are contrary to the Government policy that cash advances be made monthly or more frequently to meet borrowers' current disbursement needs. The instructions also do not provide for the use of letters of credit for borrowers who receive advances totaling \$250,000 or more annually. As a result, Government funds have been disbursed in advance of the time the funds were actually needed by the borrowers thus accelerating Government borrowings and increasing related interest costs.

GOVERNMENT POLICIES AND PROCEDURES
ON CASH ADVANCES

Treasury Department Circular No. 1075 (revised), dated April 10, 1969, states that cash advances to recipient organizations--including State and local governments, educational institutions, international organizations, and any other public and private organizations--be limited to the minimum amounts needed and be timed to be in accord with the actual cash requirements of the organizations.

The circular states also that, for relatively small operations where the aggregate annual advances are under \$250,000, cash advances to recipient organizations be made monthly or more frequently to meet current disbursement needs and that, for larger operations, the timing and amount of cash advances to recipient organizations be as close to actual daily disbursements as is administratively feasible.

The circular provides for two methods of advancing funds to borrowers: the conventional method of advancing cash by Treasury check and the letter of credit method. According to the circular, if an agency has, or expects to have, a continuing relationship with a recipient organization for at least 1 year, involving annual advances of at least \$250,000, the agency may use whichever method best meets its own operating objectives provided that the two methods are equally advantageous to the Federal Government in terms of the timing of cash withdrawals from the Treasury.

Under the method of issuing a Treasury check, it must be practicable to issue the advance to a recipient organization in coordination with its actual cash requirements.

The letter of credit is a commitment, certified by an authorized official of a Federal agency, specifying a dollar limit available to a designated payee. The recipient organization selects a commercial bank which agrees to receive payment vouchers drawn on the Treasurer of the United States and to forward such vouchers to the applicable Federal Reserve Bank or branch.

As funds are needed the recipient organization submits a payment voucher to the commercial bank for transmission to the Federal Reserve Bank or branch. After the Federal Reserve Bank determines that the amount is within the available balance of the letter of credit, it credits the reserve account of the commercial bank and charges the account of the Treasurer of the United States.

The recipient organization sends a copy of the payment voucher to the lending agency which records the expenditure in the appropriate accounts. At the end of the month the agency reports to the Treasury Department the expenditures relating to the letter of credit transactions.

REA POLICIES AND PROCEDURES
ON CASH ADVANCES

REA's instructions concerning the advance of funds for telephone facilities provide that borrowers' requests for funds be in amounts sufficient to meet the borrowers' expenditure requirements for the next 60 days. REA's instructions regarding loans for electric facilities require borrowers to submit their requests for funds no more often than once a month. REA advances cash by Treasury check and does not use letters of credit.

In a letter to all REA borrowers, dated February 1, 1971, the REA Administrator stated that advances of funds should generally be requested on the basis of their requirements for the next 60 days. The Administrator said that the limitation was necessary for REA to adequately meet minimum cash needs of all borrowers.

ADVANCE OF FUNDS PRIOR TO
BORROWERS' NEEDS

We selected 21 borrowers who had been advanced funds of about \$155 million during the period February 1, 1968, to June 30, 1971, to finance the improvement, construction, or operation of electric and telephone facilities in nine States and analyzed their cash balances during that period. We selected these 21 borrowers because they had received a significant amount--about \$155 million--of the \$1.7 billion REA advanced to all borrowers during the period.

Our analysis showed that REA had advanced significant amounts of funds to the 21 borrowers even though substantial portions of preceding advances were not expended. We estimate that the Government could have realized interest savings of about \$467,000 if REA had advanced the funds to the 21 borrowers only as needed.

We computed the estimated interest savings by applying the difference between the 2 percent rate the borrowers were paying on their loans and the average interest rate paid by the Treasury on all marketable obligations to the amount of the advances in excess of the borrowers' requirements during each month.

There was little consistency among borrowers as to the basis on which they requested advances from REA. For example, one borrower asked for funds only to cover prior expenditures and any current unpaid invoices on hand; another borrower requested funds for up to 6 months in advance.

For fiscal year 1972, REA expects to make electric and telephone loans totaling about \$572 million and will continue to make advances from loan funds obligated during previous years. If these funds are advanced on the basis of cash requirements, significant savings could be realized.

The following example illustrates how REA's practice of advancing funds results in borrowers' having cash in excess of their requirements.

A borrower in the State of North Dakota received advances totaling \$2,031,509 in REA funds during the 41-month period from February 1, 1968, to June 30, 1971. The following table shows, for this borrower, the receipts, disbursements, and month-end balances of funds for the 18-month period, January 1, 1970, to June 30, 1971.

<u>Year and month</u>	<u>Funds</u>		<u>Balance of funds at end of month</u>
	<u>Received</u>	<u>Disbursed</u>	
1970:			
Jan.			\$166,568
Feb.	\$258,586		425,154
Mar.		\$157,995	267,159
Apr.		9,317	257,842
May		8,851	248,991
June			248,991
July		1,035	247,956
Aug.		109,567	138,389
Sept.	521,006	104,069	555,326
Oct.		166,195	389,131
Nov.		138,075	251,056
Dec.		45,702	205,354
1971:			
Jan.			205,354
Feb.		1,477	203,877
Mar.		13,210	190,667
Apr.		802	189,865
May		14,362	175,503
June		147,290	28,213

We estimated that the Government could have realized interest savings of about \$8,700 for this borrower during the 18-month period if REA had advanced funds only as needed. For the 41-month period, we estimated that the Government could have realized about \$18,400 in interest savings for this borrower.

We discussed the timing of REA advances and the feasibility of using a letter of credit arrangement with officials of a number of borrowers. Also we obtained comments on the feasibility of using letters of credit from officials of banks which had borrowers' construction fund accounts.

Some of the borrower officials told us that uncontrollable factors, such as adverse weather conditions and strikes by employees in the construction and transportation industries, slowed down construction work and affected cash requirements. Such circumstances make it difficult to coordinate loan advances by Treasury check with actual cash requirements.

In general, the borrower officials stated that the use of letters of credit would be advantageous because the borrower would not pay interest

until loan funds were actually withdrawn, yet the funds would be available when needed. The bank officials stated, in general, that the use of letters of credit would be feasible.

CONCLUSIONS

REA should revise its practices and instructions for advancing funds to borrowers to achieve the objective of the Government's policy of timing cash advances with the recipients' actual needs. To accomplish this objective, borrowers would need to estimate their cash requirements over shorter periods of time than they presently do. Also REA should review and analyze the borrowers' estimates of cash requirements and, in accordance with the Government's general policy, establish policies and procedures governing the use of letters of credit for borrowers who are expected to receive advances totaling \$250,000 or more annually.

RECOMMENDATIONS

We recommend that REA

- revise its instructions to require that advances be made monthly or more frequently to meet borrowers' current disbursement needs,
- establish a program for systematically monitoring the advance of funds to borrowers to provide assurance that advances are made in accordance with the borrowers' actual needs, and
- establish policies and procedures governing the use of letters of credit for borrowers who are expected to receive advances totaling \$250,000 or more annually.

SCOPE OF REVIEW

Our review was made at the REA headquarters office in Washington, D.C., and at the administrative offices of 21 REA borrowers. We reviewed the pertinent policies and procedures under which REA advances funds to borrowers and examined records pertaining to the construction fund accounts and to the receiving and processing of loan fund advance requests for 21 borrowers in nine States. Also we interviewed officials of REA, the borrowers, and banks which had borrowers' construction fund accounts.