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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D C 20548

RESOURCES AND ECONOMIC  
DEVELOPMENT DIVISION

APR 01 1974

Mr. George P. Herzog  
Assistant Administrator-Administration  
Rural Electrification Administration  
Department of Agriculture  
14th and Independence Avenue, SW.  
Washington, D.C. 20250

Dear Mr. Herzog

Our report to the Congress on the examination of the Rural Telephone Bank's fiscal year 1973 financial statements is in final process. We would like to use this letter to comment on several matters noted during our audit.

Allowance for possible losses  
on loans and interest receivable

In our draft report we pointed out that minor discrepancies resulted from the application of the policy on allowance for possible losses on loans and interest receivable adopted by the Bank's Board of Directors. The policy provides that the allowance be increased each year by .024 percent of the loans outstanding as of the close of each fiscal year until a maximum allowance of 0.6 percent of loans receivable is attained in about 25 years.

In fiscal year 1973, the allowance was computed at the close of each quarter for presentation in the quarterly report to the directors. An allowance of \$6,000 was accrued under this method. However, had the annual rate of .024 percent been applied to the loans receivable outstanding at the close of the fiscal year, the accrual for the allowance for losses would have been about \$11,000. In addition, the use of an annual rate of .024 percent to compute the allowance for losses will not achieve the maximum allowance set forth by the directors. The annual rate must be increased each year by .024 percent to achieve the maximum allowance, i.e., .024 percent the first year, .048 the second year, etc.

This was discussed with the Chief and Assistant Chief of the Accounting Branch who concurred that the allowance schedule should be revised. We understand that a new allowance schedule which includes the cumulative

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annual allowance rates has been developed and will be used for future computations.

We also suggest that after the Bank has gained additional operational experience, it annually review the method used to compute the allowance and revise it if necessary. In this review, the Bank should consider losses, if any, experienced by the Rural Electrification Administration (REA) on its telephone loans.

Benefits to be derived from  
periodic internal audits

At present, periodic internal audits are not made of the Bank's operations. We believe there would be merit in your consideration of the benefits of periodic reviews.

As you know, audit coverage by an agency of its programs is a constructive aid in determining whether funds have been applied efficiently, economically, effectively, and in a manner that is consistent with related laws and program objectives. As the Bank continues to grow, management's ability to directly observe the details of current operations decreases and it must rely more on accounting and other reports for information. Periodic audits of the Bank's operations would contribute to your being able to better rely on internal reports and have some assurance that policies formulated by management are being effectively implemented.

We suggest that you give consideration to requesting that the Director, Office of Audits, Department of Agriculture, plan for periodic reviews of the Bank. We would be happy to meet, at your convenience, to discuss further the pros and cons of this suggestion.

Statistical data

We noted that the semiannual statistical summaries for the REA and the Bank's rural telephone program combined REA- and Bank-approved loan data. The combined loan data concerns miles of telephone lines, the number of subscribers to receive initial or improved service, and the purpose for which the loans were approved, such as construction, refinancing, and acquisitions.

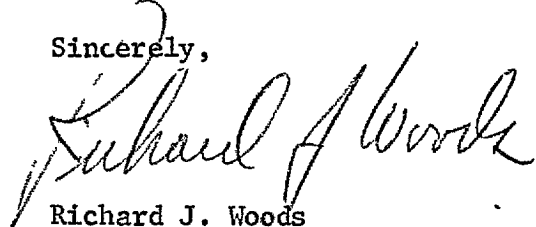
Although we did not attempt to determine the feasibility or the costs involved in separating the data it could be useful to have the data for these categories identified specifically as REA or Bank data. Such an identification would give more management visibility to annual changes in components of the program and where growth was being achieved.

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We appreciate the courtesies extended to us during the review and would appreciate receiving your comments on these matters and advice as to any action taken or contemplated. If you have any questions or desire to meet to discuss the observations, please contact Mr. H. L. Krieger, Regional Manager, Washington Regional Office, on 557-2151.

A copy of this letter is being sent to Mr Leonard H. Greess, Director of the Office of Audits, for his information and use.

Sincerely,

A handwritten signature in cursive script that reads "Richard J. Woods". The signature is written in dark ink and is positioned above the printed name and title.

Richard J. Woods  
Assistant Director