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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114873

APR 7 - 1975

The Honorable
The Secretary of Agriculture

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Dear Mr. Secretary:

Pursuant to section 309(g)(2) of the Consolidated Farm and Rural Development Act (7 U.S.C. 1929(g)(2)), we have reviewed (1) the Farmers Home Administration's (FmHA's) determination of the value of the Government's equity transferred in September 1972 from its Direct Loan Account and Emergency Credit Revolving Fund to the Agricultural Credit Insurance Fund and (2) FmHA's subsequent computations of changes in this equity.

We made our review primarily at FmHA's national office in Washington, D.C., and its Finance Office in St. Louis, Missouri. We reviewed applicable legislation and FmHA procedures and records and discussed these matters with officials of the Departments of Agriculture and the Treasury and the Office of Management and Budget (OMB).

Section 309(g)(1), which was added to the consolidated act by the Rural Development Act of 1972, provides that the assets and liabilities of FmHA's Direct Loan Account and Emergency Credit Revolving Fund be transferred to the insurance fund and that the account and the revolving fund be abolished. Section 309(g)(2) requires that, from time to time and at least at the close of each fiscal year, the Secretary of Agriculture pay from the insurance fund into the Treasury interest on the value of the Government's equity transferred to the insurance fund as determined by the Secretary, with approval of the Comptroller General. Section 309 (g)(2) provides also that the value be increased by the cumulative amount of appropriations, made available after enactment of this provision, for capital and for administration of the programs financed from the insurance fund and be reduced by the average undisbursed cash balance in the insurance fund during the year.

The legislative history of the Rural Development Act is silent as to the intent of the Congress in requiring the payment of interest on equity transferred to the insurance fund.

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Because of certain deficiencies in FmHA's accounting system, the value of the Government's equity, as determined and transferred by FmHA, may not be accurate. Further, because the account and the revolving fund have been abolished and their assets and liabilities are now commingled with those of the insurance fund, the equity value on which interest should be computed cannot be determined. Consequently, we are unable to approve the Department's determinations of the Government's equity upon which the interest is computed.

Because of these problems and because continuation of present interest computation procedures may result in FmHA's eventually paying excessive and inequitable interest, FmHA has proposed that the Congress repeal section 309(g)(2) of the consolidated act.

EQUITY TRANSFERRED AND INTEREST PAID

FmHA records show that the assets and liabilities of the account and revolving fund were transferred to the insurance fund on September 30, 1972, at the net book value of $532.5 million. Included in the assets transferred were about 200,000 loans receivable amounting to about $1 billion.

On June 30, 1973, FmHA paid about $3.8 million in interest into the Treasury on a fixed equity of $532.5 million, as adjusted for the cancellation of emergency loans 1/ and the average undisbursed cash balance in the insurance fund. FmHA paid no interest on June 30, 1974, because the value of the net equity transferred plus fiscal year 1974 appropriations--about $74.5 million--did not exceed adjustments for the cancellation of emergency loans and the average undisbursed cash balance in the insurance fund. Fiscal year 1975 appropriations, through January 31, 1975, totaled about $485.3 million.

DETERMINATION OF VALUE OF GOVERNMENT'S EQUITY

At the time of transfer, FmHA's accounting records contained about the same deficiencies as those discussed in our December 30, 1970, report entitled "Improvements Needed in Financial Statements of the Emergency Credit Revolving Fund of the Farmers Home Administration" (B-114873). These deficiencies included (1) the lack of adequate support

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[1] Such cancellations were formerly authorized by section 328(a)(1) of the Consolidated Farm and Rural Development Act, as added by section 5 of Public Law 92-385 (7 U.S.C. 1969 (Supp. II, 1972)), and repealed by section 1, Public Law 93-24. Although repealed, this authority to cancel loans has been afforded limited extensions pursuant to section 8 of Public Law 93-24 and section 4 of Public Law 93-237 (7 U.S.C. 1969 note (Supp. III, 1973)).

for estimates of future losses on loans, (2) the misstatement of cash and acquired security property account balances because transactions had not been recorded promptly, and (3) the distortion of reported costs of operations because of the unsound basis for determining the administrative expenses chargeable to the loan programs.

In our report, we expressed the opinion that, because of these deficiencies and material understatements of costs, the revolving fund's financial statements--which were furnished to the Treasury Department pursuant to Treasury Circular 966--did not present fairly the fund's financial position at December 31, 1968, and the results of the emergency loan operations for the 6-month period ended December 31, 1968. Because these deficiencies continued, we believe that a determination of the value of the Government's equity to be transferred could not be made with reasonable assurance of its accuracy.

COMPUTATION OF INTEREST

In computing the amounts of interest to be paid on the equity subsequent to transfer, FmHA considered the equity to be a fixed amount. Inasmuch as the act requires interest to be paid into the Treasury from time to time and at least annually, we believe it was intended that interest payments be computed on the net equity transferred to the insurance fund as increased or decreased by subsequent operating gains and losses (including emergency loan cancellations) and as adjusted by appropriations and cash in the fund. If the equity remains fixed and operating gains and losses are not considered, cumulative appropriations will cause the base for the interest payment to continually increase with no increase in equity. We believe the Congress did not intend section 309(g)(2) to lead to such a result.

When the transfer was made, the assets and liabilities of the account and the revolving fund were commingled with assets and liabilities already in the insurance fund. Therefore, the equity transferred became an inseparable part of the equity in the insurance fund and the value of that portion of the equity on which interest should be computed cannot now be determined.

FmHA COMMENTS

By letter dated August 5, 1974, we informed the FmHA Administrator of the above facts. We said that, in view of the deficiencies in the accounting procedures and the commingling of the assets and liabilities, it appeared that it might not be practical or even possible for FmHA to determine the correct value of the Government's equity at the date of transfer or the adjusted value on which interest should be paid in subsequent periods. We requested his views on this matter.

In a reply dated November 8, 1974, the Administrator said that steps would be taken to correct certain of the deficiencies in FmHA's accounting procedures. These steps involved computerizing the acquired security property accounts and establishing a task force to redesign FmHA's work measurement system.

The Administrator agreed that, as a result of the commingling of the assets and liabilities, it was no longer possible to identify the operating gains and losses attributable to the equity transferred but said that retaining separate accounts for the assets and liabilities transferred to the insurance fund would have defeated the purpose of consolidating the accounts.

The Administrator said that, in view of the situation, FmHA could only continue to base interest payments on the equity established at the time of transfer, as adjusted by subsequent appropriations, or request the Congress to repeal the section of the act which requires interest payments to the Treasury.

In January 1975 an FmHA official told us that FmHA had initiated a proposal for legislation repealing the interest payment requirement. In February 1975 this official said that the Department had submitted the proposal to OMB for approval before submitting it to the Congress.

The OMB official responsible for reviewing FmHA's proposal to repeal the interest payment requirement told us that other possible solutions to the problem would also be considered. He said that comments would be obtained from other OMB officials as well as from Treasury officials. He expects a final decision by the executive branch on this matter by April 1975.

CONCLUSION

Because of the deficiencies in FmHA's accounting system, the value of the Government's equity, as determined and transferred by FmHA, may not be accurate. Further, because the account and revolving fund have been abolished and their assets and liabilities are now commingled with those of the insurance fund, the equity value on which interest should be computed cannot be determined. Consequently, we are unable to approve the Department's determinations of the Government's equity upon which interest is to be computed and paid into the Treasury.

FmHA's proposal to repeal section 309(g)(2) would resolve the problem of determining the value of the Government's equity upon which interest is to be computed. As noted by the OMB official, however, there may be alternative methods of resolving this problem.

We are sending copies of this report to the Secretary of the Treasury; the Director, OMB; the Chairmen, House and Senate Committees

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on Appropriations and Government Operations; the Chairman, Senate Committee on Agriculture and Forestry; the Chairman, House Committee on Agriculture; the Chairman, Senate Appropriati ns Subcommittee on Agriculture and Related Agencies; and Congressman L. H. Fountain, pursuant to his request. We are also sending copies to you Assistant Secretary for Rural Development; the Administrator, FmHA; and the Director, Office of Audit.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States