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

ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

B-202690

The Honorable Everett Rank
Executive Vice President
Commodity Credit Corporation
Department of Agriculture

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Dear Mr. Rank:

Subject: Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans (AFMD-82-40)

As you are aware, we concluded our review of the Commodity Credit Corporation's (CCC) financial statements for fiscal year 1980 and issued our report (CED-91-137, August 13, 1981). As a result of information gathered during the course of our review, we believe CCC's practice of applying repayments of tobacco associations' loans first to principal and then to accrued interest is inconsistent both with CCC's procedures for repaying its Treasury borrowings and with normal banking practices.

Under the CCC accounting system, accrued interest on tobacco loans is computed and maintained in memorandum records. Cash received from loan repayments is applied first to loan principal, then, after the principal is liquidated, to interest receivable. The memorandum record of accrued interest is reduced by the same amount. Cash received beyond liquidation of accrued interest is returned to the tobacco associations. However, if cash collections are insufficient, the memorandum account is closed and the receivable waived.

CCC Docket HP 40a, as approved by the Secretary of Agriculture on January 28, 1966, provided that sales proceeds from 1966 and prior years' loans outstanding be applied first to loan principal and then to accrued interest. This change from the prior rule, which applied up to 2-1/2 cents of every dollar to interest and 97-1/2 cents to principal, was recommended as a means of eliminating unproductive computations and reducing recordkeeping. The change also resulted in recording interest income on tobacco

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loans only when the proceeds from loan collateral dispositions exceeded the principal amount of the loans. The docket stated that a loss in accrued interest receivable resulting from a more rapid liquidation of loan principal would not be significant.

The low interest rates of 1966 (3.5 percent) may have justified dispensing with the control over accrued interest receivable. However, the same justification does not exist today. CCC was required on June 30, 1981, for example, to pay interest at a rate of 15.825 percent for its borrowings. We calculated, using data from crop years 1978-80, that the present practice cost CCC almost $2 million in 1980 in lost revenue which is mostly to the benefit of the tobacco associations in the form of reduced interest payments.

Treasury charges CCC interest on the daily outstanding balance owed, which, on January 1 and July 1, includes unpaid interest on borrowings from prior periods. In contrast, the tobacco associations are paying interest to CCC on the daily outstanding principal balances, which do not include interest from prior periods. As a result, the tobacco associations are paying interest at substantially reduced amounts because their loan principal balances are more rapidly reduced as they apply sales proceeds (under the provisions of the 1966 docket) first to loan principal, until liquidated, and then to accrued interest.

To summarize, a significant difference exists between the recording and collection of interest on CCC tobacco loans (and others, such as loans on warehouse stored peanuts) and the corresponding interest which CCC pays Treasury for borrowed funds. In view of the magnitude of this difference and the need to address it, we recommend that CCC:

--Cancel or modify the interest computation provision of CCC Docket HCP 40a to bring it more in line with the method followed by CCC for its own Treasury borrowings, and

--Revise interest computation procedures on other comparable programs or activities for which CCC also may not be recovering comparable borrowing costs.

We discussed these issues with CCC's Comptroller who generally agreed with our findings. He pointed out, however, that although the Department of Agriculture's appropriation bill contains language that imposes new restrictions on the tobacco program, our recommendation could result in additional costs to CCC if the tobacco associations were to press for accommodations which currently are not part of their program--for example, partial redemptions. He stated that the probability of such accommodations being granted, and their cost, is unknown.

We do not intend that our recommendations should result in additional costs to CCC. We believe tightening interest computation procedures is consistent with the new limits placed on the tobacco program, and that CCC need not incur a loss on the program if other compatible program changes were also made; for example, adjusting loan rates by grade of tobacco.

If you have any questions or wish to discuss this matter further, we will be happy to meet with you or your staff. We would appreciate being kept informed of any changes that you may implement or as a result of this recommendation.

Sincerely,

Ronald J. Points
Associate Director