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

June 16, 1982

COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

B-207895

The Honorable Robert N. Shamansky
House of Representatives

Dear Mr. Shamansky:

Subject: Information on Commodity Credit Corporation Loan Repayment Practices (GAO/CED-82-106)

In response to your May 27, 1982, request and subsequent discussions with you, we obtained certain information on the Commodity Credit Corporation's loan repayment practices for tobacco and other commodities. In addition to responding to your specific questions, this report provides general background information on the Corporation.

In summary, the information obtained showed that:

--The Corporation allows loan repayments for the Tobacco and Peanut Support Programs to be applied first to principal and then to interest. This is contrary to commercial practices, which generally provide for the application of loan collections first to accrued interest due and then to the principal indebtedness.

--There is no statutory authority which specifically states how loan repayments are to be applied.

--The memorandum account, an account used by the Corporation to record interest due on nonrecourse loans, did not meet generally accepted accounting practices and is no longer used.

PROGRAM DESCRIPTION

The Commodity Credit Corporation was created to stabilize, support, and protect farm income and prices; to help maintain balanced and adequate supplies of agricultural commodities and products; and to facilitate the orderly distribution of commodities. The Corporation is a wholly owned Government corporation which, in addition to carrying out its other programs, acquires commodities through price support and other programs. The Corporation has no operating personnel; its programs are carried out primarily through the personnel and facilities of the Department of Agriculture's Agricultural Stabilization and Conservation Service, hereafter referred to as the Service.

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The Corporation provides price stabilization and support for tobacco and other commodities through loan, purchase, and payment programs. Price-support programs are designed to provide producers of specified agricultural commodities the opportunity to obtain a certain return on their production regardless of fluctuations in market prices. In accordance with section 405 of the Agricultural Act of 1949, as amended (7 U.S.C. 1425), price-support loans made by the Corporation are nonrecourse loans.

Price stabilization and support operations are provided to tobacco producers through a price-support loan program. However, the Corporation does not directly administer the Tobacco Price-Support Program. Instead, it contracts with 13 producer cooperative associations for that purpose. Price support is extended by means of nonrecourse loans made through the associations to their members, with financing by the Corporation. Nonrecourse loans absolve producers from liability for any losses incurred from the sales of the tobacco by the producer associations. Net gains, if any, are distributed to the producers based on participation, whereas losses are absorbed by the Corporation.

The associations handle all operations related to making the loan advances to producers and receiving, processing, storing, and eventually selling the tobacco taken under loan. Loans by the Corporation include advances to producers and amounts paid for receiving, processing, and storing the tobacco. Over time, the associations market the tobacco under loan based on prices proposed by the associations and approved by the Corporation. Sale proceeds are applied toward repayment of the principal first and then the interest accrued on the loans.

OBJECTIVES, SCOPE, AND METHODOLOGY

Pursuant to your request, our objectives were to gather information which relates to

--past and present Corporation repayment practices;

--the explicit statutory and/or regulatory authority which allows the Corporation to decide how loan repayments are to be divided between principal and interest, as well as the authority to establish a memorandum account for accrued interest;

--what a memorandum account is and whether it meets generally accepted accounting principles;

--how Corporation repayment practices differ from commercial banking practices; and

--other Corporation loan programs which allow repayments to be applied first to loan principal.

We reviewed applicable legislation, implementing regulations, publications, and pertinent policies and procedures. We interviewed Corporation and Service officials in Washington and coordinated our work with the Department's Office of Inspector General. Due to time constraints, we relied extensively on readily available Corporation records and did not independently verify the data.

REPAYMENT PRACTICE HISTORY

The Corporation's Controller told us that he was not aware of any compilation or history of past and present Corporation repayment practices. However, we did obtain Corporation dockets which describe the computation and application of interest on nonrecourse loans.

Docket *C 152a, April 28, 1948, provided that the proceeds from the sale of tobacco held as collateral on loans prior to, at, or after the maturity date of the loan should be applied pro rata to total principal and interest owed. The 1966 Tobacco Price-Support Program, Docket HCP 40a, January 28, 1966, changed this practice by providing that sale proceeds from 1966 and outstanding prior year loans be applied first to loan principal and then to accrued interest. The change from the prior rule for applying up to 2-1/2 cents from every dollar to interest and 97-1/2 cents to the principal was recommended as a means of eliminating unproductive computations and reducing recordkeeping. The change resulted in a recording of interest income on tobacco loans only when the proceeds from loan collateral dispositions exceeded the principal amount of the loan. According to the docket, the reduced accrued interest which would result from the more rapid liquidation of the loan principal would not be significant.

Docket CZ 152a, Revision 1, May 28, 1968, provides that the proceeds from the sale of loan collateral and other amounts applicable to loans to producer associations, which do not provide for partial redemptions, shall be applied first to principal and then to interest. Partial redemption of the loan collateral is not authorized for the tobacco loan program.

AUTHORITY FOR LOAN REPAYMENTS AND ESTABLISHMENT OF MEMORANDUM ACCOUNTS

According to the Corporation's Controller and a Department staff attorney, there is no statutory authority which specifically states how loan repayments are to be applied. They state that the Corporation's Charter Act, as amended (15 U.S.C. 714 et seq.), and the Agricultural Act of 1949, as amended (7 U.S.C. 1421 et seq.), provide the broad general authority which allows the Secretary to administratively determine what portion of loan repayments are to be applied to principal and to interest.

Section 401 of the 1949 act, 7 U.S.C. 1421, gives the Secretary the authority to provide a price-support program and to determine the amounts, terms, and conditions of price-support operations. Section 5(a), 15 U.S.C. 714 c(a), of the Charter Act authorizes the Corporation to support the price of agricultural commodities through loans, purchases, payments, and other operations. Section 4(j), 15 U.S.C. 714 b(j), allows the Corporation to determine the character of and the necessity for its obligations and expenditures and the manner in which they shall be incurred, allowed, and paid.

The Secretary exercises his authority to provide for a tobacco price-support program usually through a docket, passed by the Corporation's Board of Directors, which he approves. The docket, among other things, sets the terms and conditions of the programs and describes the need and justification for establishing policies on the computation of interest and the application of collections to principal and interest. The Secretary also used this authority to establish a memorandum account for accrued interest on nonrecourse loans.

MEMORANDUM ACCOUNT FOR ACCRUED INTEREST

Before fiscal year 1981, the Corporation recorded interest due on nonrecourse tobacco loans in a memorandum account for accrued interest. However, the interest due, as shown in the account, was not reflected as interest income to the Corporation in its financial statements.

In our August 13, 1981, report entitled "Review of Financial Statements of Commodity Credit Corporation" (CED-81-137), we stated that the Corporation does not follow generally accepted accounting principles, which require the accrual basis of accounting with nonrecourse loans, since it does not periodically accrue interest or recognize interest income on a loan until the principal balance has been repaid.

A significant effect associated with the failure to recognize accrued interest receivable is to understate the cost of any commodity which is surrendered in payment of a loan. The cost of the commodity to the Corporation should include both the principal balance plus accrued interest.

On August 27, 1981, the Corporation's Executive Vice President agreed that the policy to record interest on nonrecourse loans on an actual receipt basis rather than on an accrual basis is not in accordance with generally accepted accounting principles. The accounting policy of the Corporation was changed, effective with the 1981 fiscal year, to provide for accrual of interest income on nonrecourse loans, and interest income was included in the fiscal year 1981 financial statement.

COMMERCIAL PRACTICES VERSUS CORPORATION REPAYMENT PRACTICES

Commercial banking practices provide generally for the application of loan collections first to accrued interest due from the borrower and then to the principal indebtedness. The loans usually have a fixed maturity date with payments made on a periodic basis (monthly) and have a fixed interest and principal repayment schedule. This rule has the practical effect of maintaining the principal balance at the highest level and increasing the amount payable by the borrower as interest and is recognized as being within the right of the lender. However, according to the Corporation's Controller, no loans made by commercial banking facilities are comparable to the nonrecourse loans made by the Corporation.

Nonrecourse Corporation tobacco loans made to producer associations do not have a fixed maturity date and are liquidated by disposition of the tobacco held as collateral as authorized by the Corporation. Nonrecourse loans absolve producers from liability for any losses incurred from the sale of the tobacco by the producer associations.

Under the Corporation's accounting system, cash received from loan repayments is applied first to loan principal, then, after the principal is liquidated, to interest receivable. Cash received beyond liquidation of accrued interest is returned to the tobacco associations. However, if the cash collected after the loan principal is liquidated is insufficient to liquidate the total interest due, the account is closed and the receivable waived.

In a January 11, 1982, letter report to the Corporation's Executive Vice President entitled "Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans" (AFMD-82-40), we recommended that a change be made in the practice of applying sales proceeds first to principal and then to accrued interest.

In an April 15, 1982, letter to the Director, Analysis Division, Agricultural Stabilization and Conservation Service, the Corporation's Controller agreed that our recommendation was valid and that sales proceeds in the future will be allocated to loan principal and accrued interest. However, as of June 16, 1982, the Corporation had not established the formula for allocation between principal and interest.

PEANUT LOAN PROGRAM SIMILAR TO TOBACCO

According to the Controller, the Tobacco and Peanut Price-Support Programs are the only two support programs in which the Corporation allows repayments to be applied first to loan principal and, when liquidated, to interest. These are also the only commodities where partial redemption of the loan collateral is not authorized.

The Peanut Support Program is carried out primarily through nonrecourse warehouse-storage loans to approved grower associations acting for farmers. Also, the price may be supported through loans to producers on farm-stored peanuts and through purchases from producers. From the inception of the program through September 30, 1980, about $1.1 billion in loan principal was not recovered, resulting in losses to the Corporation.

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At your request we did not take the additional time to obtain written agency comments on the matters discussed in this report. However, we did obtain oral comments from the Controller of the Corporation and appropriate changes were made to the report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested parties and make copies available upon request.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director