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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

CIVIL DIVISION

JUL 6 1970

Dear Mr. Armstrong.

The General Accounting Office has reviewed certain aspects of the policies followed by the Bureau of Reclamation (Bureau) in computing interest expense on the Federal investment in water resources projects. We limited our review to the effect that these policies have on the financial statements and the repayment plans for the Federal Columbia River Power System (FCRPS).

Our opinion letters to the audited FCRPS financial statements for fiscal year 1969 and earlier years have commented on the variations in the methods used by the entities of FCRPS in recording interest on the Federal investment and the need to resolve this matter for improved disclosure of the financial position and results of operations of the integrated power system.

The Bureau currently computes annual interest expense only on the beginning fiscal year balance in the Federal investment. This balance consists of the commercial electric Plant-in-Service plus retirement work in progress less any repayments of investment. This method of computing interest on investment excludes from consideration funds used for additional investments between the beginning and end of the year--net additions to Plant-in-Service and related accounts, and current operation and maintenance expenses. The Bonneville Power Administration (BPA) and the Corps of Engineers (Corps) consider such items in computing interest expense.

Computation of interest cost on changes during the year in the Federal investment is required by the Accounting Principles and Standards for Federal Agencies prescribed by the Comptroller General. Subsection 16.8(e) states that the interest cost for each year should be determined on the net Federal investment in the program or activity at the beginning of the year and on the net additions to such investment during the year. Also, the computation of interest cost by the Bureau on its net additions to the Federal investment during the year would provide consistency with the policy followed by the other entities of the FCRPS whose financial results are consolidated for financial statement purposes.

We computed what the interest would have been on net additions to the Federal investment during fiscal year 1969 on the Bureau projects included in the FCRPS, using a method similar to that used by the Corps. We used an interest rate of 3-1/4 percent, which is the same rate that BPA used in its computation of interest cost on changes in the Federal investment. Our computation showed that about $77,000 of additional interest cost would have been included in the FCRPS financial statements and repayment plans for fiscal year 1969 if the Bureau had computed interest on net additions to the Federal investment, as follows

1. Interest on the current year net additions to Plant-in-Service and related accounts	$14,000
2. Interest on the current year net operation and maintenance expense	63,000
Total additional interest cost	$77,000

Authorizing legislation does not provide a specific interest rate to be used on funds needed for additions to plant or funds needed to operate and maintain a project. The interest rates used for most Bureau projects were established by the Bureau pursuant to section 9(c) of the Reclamation Project Act of 1939 (43 U S.C. 485h(c)), which provides that power rates be established to cover, in addition to other items, interest on an appropriate share of the unrepaid construction investment at not less than 3 percent per annum.

Although for purposes of our computation we have used the BPA rate of 3-1/4 percent for interest, we believe that the rate should be established by the Secretary of the Treasury and should take into consideration the average market yield, during the year in which the investment is made, on the outstanding marketable obligations considered to be most representative of the cost to the Treasury of borrowing money. The interest rate criteria which we believe should be followed is discussed in detail in our report to the Congress entitled "Change Proposed in Interest Rate Criteria for Determining Financing Costs of Federal Power Program" (B-167712 dated January 13, 1970).

A cognizant Bureau official in Region 1 indicated that the reason for the Bureau's policy not to compute interest expense on additions to the Federal investment during the year is that the Bureau has an agreement with BPA which, in effect, provides that sufficient system revenues will be allocated by BPA each year to pay for such Bureau additions We found, however, that the system revenues are not allocated by BPA until the end of the year and that, in the interim, BPA considers that such revenues are invested with the Federal Government and earn interest income at a rate of 3-1/4 percent. This imputed annual interest income is deducted by BPA from the imputed annual interest expense owed on the Federal investment in BPA.

During fiscal year 1969, BPA allocated $31 million of system revenue to the Bureau projects in the FCRPS. Interest income (inverse interest) on this allocated revenue, at 3-1/4 percent for one-half a year, would amount to about $500,000. If the Bureau, instead of BPA, had been credited with the inverse interest applicable to system revenue allocated to the Bureau, net interest expense to the Bureau would have been reduced and such expense to BPA correspondingly increased. From a system standpoint, however, net interest expense would have been increased by the $77,000 described previously if the Bureau were to impute interest expense on net additions to the Federal investment during the year.

Since the system revenues are considered by BPA as being invested from the date received until the end of the fiscal year, we believe that such revenues reasonably cannot be considered as having been used to pay for additions to the Federal investment until the end of the year. Therefore, we believe that interest expense should be computed by the Bureau on additions to the Federal investment during the year.

Bureau officials in Region 1 believed that another reason for the Bureau's policy not to compute interest expense on changes during the year in the Federal investment is that the Bureau's operations are financed from funds appropriated from the Reclamation Fund rather than from general funds available to the Treasury. The officials stated, in effect, that the Reclamation Fund operates much like a revolving fund with the Bureau revenues deposited in the Fund and its expenses for operation and maintenance, and much of the cost for additional project improvements, paid with appropriations out of the Fund.

In our opinion, the fact that certain costs are paid with appropriations from the Reclamation Fund is not a valid reason for the policy not to compute interest expense on the changes during the year in the Federal investment. In this connection subsection 16.8(e) of the Comptroller General's Accounting Principles and Standards for Federal Agencies provides that

> "Interest is a cost generally applicable to all Federal Government expenditures. This concept is based on the fact the Government's disbursements are made from a single pool of funds in the Federal Treasury which are not earmarked as to source or use If funds disbursed for any given purpose had not been so disbursed, they could have been applied to repay or reduce borrowings, with a consequent savings in interest costs."

Recommendation to the Commissioner of Reclamation

Accordingly, we recommend that the Bureau compute interest on net additions to the Federal investment during the year and that a retroactive adjustment be made for such interest expense not recorded in past years.

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We would appreciate receiving your comments on the foregoing matter and being advised of any action that you plan to take. We wish to express appreciation for the cooperation extended to our staff by Bureau officials during our review.

Copies of this report are being sent to the Chief of Engineers, Corps of Engineers, and to the Administrator, Bonneville Power Administration.

Sincerely yours,

A. R. Voss

Allen R. Voss
Associate Director

The Honorable Ellis L. Armstrong
Commissioner, Bureau of Reclamation
Department of the Interior
Washington, D. C. 20240