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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D C 20548

CIVIL DIVISION

APR 25 1969

Dear Mr. Frick:

The General Accounting Office has made a review of the overall effective interest rate earned by the Commodity Credit Corporation (CCC), Department of Agriculture, on repayments of grain price-support loans by producers. Our review was made pursuant to the Government Corporation Control Act (31 U.S.C. 841).

The review, made at the Kansas City Data Processing Center (DPC), Agricultural Stabilization and Conservation Service (ASCS), was directed toward evaluating CCC's policy of computing interest on price-support loans. The review pertained to 1967-crop grain loans and was made because, during an earlier review, we had noted that the effective interest rate earned by CCC on some loans was very low. We had noted, for example, that on a loan of $970,000 repaid to CCC in three installments, the effective interest rate was only 2.1 percent, due mainly to the fact that $503,000 of the loan was interest free.

Our review showed that there is a need for CCC to revise its interest computation procedure and that there are potential benefits to be derived from verification of interest computations. Our comments on these matters follow.

NEED TO REVISE INTEREST COMPUTATION PROCEDURE

Our review of selected 1967-crop loan repayments showed that the amount of interest collected under the current method was an estimated $300,000 less than the amount that would have been collected under the previous method. This difference is attributable mainly to CCC's policy of disregarding the month of repayment for interest computations.

Under the grain price-support program prior to crop year 1964, a borrower was charged interest at a rate of 3.5 percent a year on the amount repaid for the actual number of days that a loan was outstanding. In 1964, the CCC Board of Directors adopted a policy which provided for a simplified method of computing interest on price-support loans on grains and certain other commodities as specified by the

Executive Vice President. When the Board adopted the simplified method, it was anticipated that the interest computed under this method would approximate the interest computed at an annual rate of 3.5 percent.

Under the simplified method, the borrower is charged a rate of 30 cents per $100 repaid (fractions disregarded) for each calendar month or fraction thereof that the loan is outstanding, excluding the calendar month of repayment. No interest is charged if the loan is repaid in the same month as disbursed or if the amount of loan repayment is less than $100.

The stated reasons for changing the method of interest computation were that (1) the amount of interest computed under each method would be approximately the same, (2) the computation of interest would be simple, and (3) the amount of interest computed under the simplified method would remain static for an entire calendar month and, thereby, make it easier for the borrower to determine whether to repay his loan and sell his commodity.

To determine the effect of the simplified method of computing interest, we selected a random sample of 1,064 loans involving $4.4 million of repayments from the 1967 crop-year loan program. For this sample, we computed the effective interest rate for the interest received, as well as the amount of interest that would have been received had it been computed on the basis of 3.5 percent a year.

Our computations showed that the overall effective annual interest rate charged on these loans was 3.394 percent and that the effective interest rates paid by individual borrowers ranged from zero to 5.8 percent. Further details on this matter are shown in Exhibit A. Our computations also showed that the interest collected under the simplified method was $2,167 less than the amount that would have been collected if interest had been computed on the basis of 3.5 percent a year. Projecting the results of our sample to the total of loan repayments, we estimated that the amount of interest collected under the simplified method was about $300,000 less than the amount that would have been collected under the method used prior to crop year 1964.

Included in our sample were 15 loans on which repayments totaling about $35,000 were interest free. This free interest resulted from CCC's policy of excluding the calendar month of repayment in computing the amount of interest payable. For example, a loan for $16,377 was made on January 2, 1968, and repaid interest free on January 31, 1968, although the borrower had use of the money for practically a whole month.

Our sample also included loans on which there were partial interest-free repayments as a result of CCC's policy of disregarding interest on repayments of less than $100. We noted that there were repetitive interest-free repayments by producers in amounts ranging up to $99.99, and that this condition existed in most counties in Wisconsin and in some counties in Iowa. The Office of the Inspector General, Department of Agriculture, had brought this matter to the attention of departmental officials in a report dated January 26, 1968. As a result, the Department revised its instructions in July 1968 to provide that county office personnel should advise any borrower who tenders frequent loan repayments of less than $100 that this type of repayment may be considered as a scheme or device to circumvent program provisions. We found, however, that as recent as January 1969, some Wisconsin borrowers were making partial repayments of less than $100 without being charged interest.

Recommendation

In view of the fact that the present policy for computing interest results in a loss of income to the Commodity Credit Corporation, we recommend that the policy be re-evaluated. Two methods that would appear to be more equitable would be to either (1) charge interest on a daily basis, or (2) retain the present basis, but include the full month of repayment in computing interest.

POTENTIAL BENEFITS FROM VERIFICATION OF INTEREST COMPUTATIONS

Our review showed that a relatively high proportion of the loan repayment transactions--about 4.4 percent of them--involved erroneous interest computations by ASCS county offices. We believe that this rate of error may be attributable indirectly to the lack of a verification procedure.

Beginning with crop year 1964 loan repayments, the DPC discontinued the practice of verifying interest computations made by ASCS county offices. This practice was discontinued apparently because of the low error rate that had been experienced; according to DPC officials, the error rate was about 1 percent.

In our review of crop year 1967 loan repayments, we verified interest computations on 1,328 transactions. We found 59 computational errors which resulted in 26 under-collections totaling $478 and 33 over-collections of interest totaling $145, or a net under-collection of $333.

The major part of the under-collection was accounted for by one loan. If the pattern of our sampling is typical of loan repayments on an overall basis, however, the estimated amount of under-collections of interest for the 1967 crop would be almost $50,000. In a separate test of loan repayment transactions, we noted that a county office in Wisconsin made errors on 186 of 228 loan repayment transactions.

In discussing the feasibility of reinstating verification procedures with DPC officials, we were advised that from a procedural standpoint it would be feasible to accomplish the verification. They expressed some doubt, however, as to whether the cost of verification, including the cost of researching and correcting errors, would be offset by recoveries of net under-collections of interest.

We recognize that reinstating verification procedures could result in additional expense. Under present procedures, however, management cannot readily determine whether county offices are collecting the correct amount of interest. Also, the absence of verification does not appear to provide sufficient control for management to identify on a timely basis those county offices where the rate of erroneous computations is high.

Recommendation

We recommend that verification of interest computations be conducted on a test basis at the Kansas City Data Processing Center with the objective of determining whether the benefits of such procedures would outweigh any additional costs.

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By letter dated January 24, 1969, to the Secretary of Agriculture, we suggested that the Department reconsider a recommendation previously made by us that CCC revise its interest policy to provide that producers pay interest at a rate not less than the rate CCC pays to finance the loans. We understand that this matter is now under consideration. Regardless of whether any action is taken to increase interest rates, we believe that the matters presented in this letter should be considered.

We will be pleased to discuss these matters with you or members of your staff if you desire. We would appreciate being advised of actions taken on the recommendations included in this letter.

Copies of this letter are being sent today to the Controller, Commodity Credit Corporation, and to the Inspector General, Department of Agriculture.

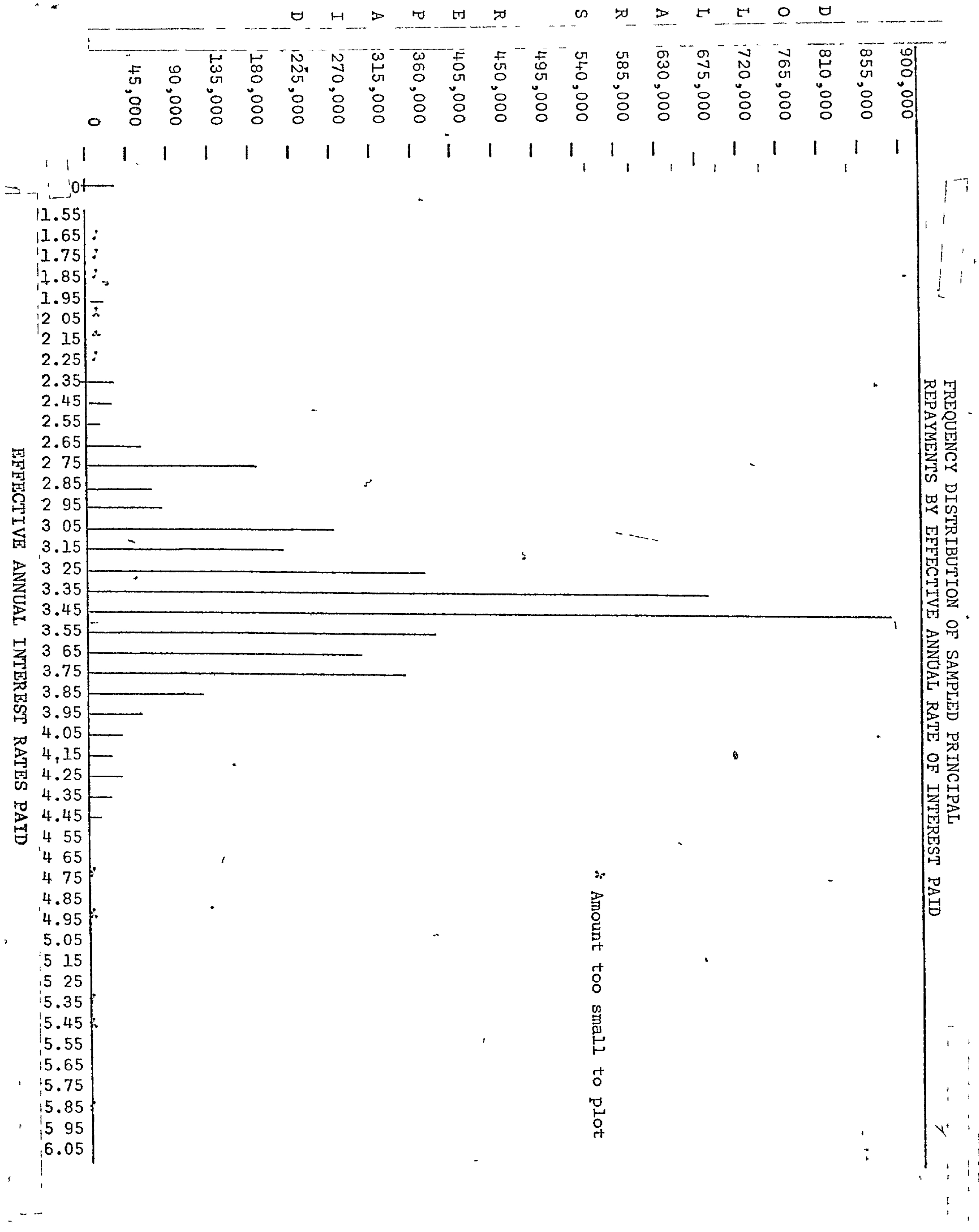
Sincerely yours,

Victor L. Lowe

Victor L. Lowe
Associate Director

Mr. Kenneth E. Frick
Executive Vice President
Commodity Credit Corporation
Department of Agriculture

EXHIBIT A


FREQUENCY DISTRIBUTION OF SAMPLED PRINCIPAL
REPAYMENTS BY EFFECTIVE ANNUAL RATE OF INTEREST PAID
DOLLARS REPAID
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90,000
135,000
180,000
225,000
270,000
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360,000
405,000
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495,000
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585,000
630,000
675,000
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765,000
810,000
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* Amount too small to plot
EFFECTIVE ANNUAL INTEREST RATES PAID