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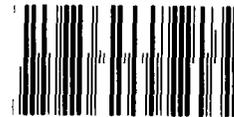
United States General Accounting Office 130275

Report to the Chairman, Committee on
Agriculture, Nutrition, and Forestry
United States Senate

May 1986

RURAL COOPERATIVES

Information on Two Rural Electrification Administration Proposals



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**Resources, Community, and
Economic Development Division****B-222848**

May 30, 1986

The Honorable Jesse Helms
Chairman, Committee on Agriculture,
Nutrition, and Forestry
United States Senate

Dear Mr. Chairman:

In your April 16, 1985, letter, and through subsequent discussions with your office, you asked that we obtain information on two proposals being considered by the Department of Agriculture's Rural Electrification Administration (REA). One proposal concerned the elimination of REA's engineering standards divisions and the second involved a proposed revision to criteria REA uses to approve loans and subsequently advance loan funds to electric cooperatives. The Chairman, Subcommittee on Government Information, Justice, and Agriculture, House Committee on Government Operations, and the Chairman, House Committee on Agriculture, have since made similar requests.

As agreed with your office and the other congressional offices, we examined REA's proposals and focused our work on the eight specific questions you raised as well as two additional questions raised by your office or the other offices. With one exception, all of the questions relate to either the advantages and disadvantages of retaining REA's engineering standards-setting functions or the basis for and potential impacts of REA's proposal to revise its criteria for approving loans. It was also agreed that we would provide copies of our report to the other Chairmen.

In carrying out our work, we reviewed REA documents and available studies that were related to its proposals. We also discussed REA's proposals with officials of the National Rural Electric Cooperative Association (NRECA), which opposes both proposals; engineering standards-setting organizations; the U.S. Department of Agriculture's Office of Inspector General; and selected rural electric cooperatives. A detailed discussion of the scope and methodology applicable to our work is contained in appendix I.

Subsequent to your request, REA's appropriations for fiscal year 1986 contained language precluding REA from reducing or denying loans or loan advances on the basis of a borrower's level of general funds. In addition, the House and Senate reports on REA's appropriation for the

1986 fiscal year advised REA that no funds were to be used for changes in the Engineering Standards Division. It was agreed with your office that the fiscal year 1986 appropriation and report language should not affect our response to your request since the language only affects fiscal year 1986 appropriations and the issues need to be resolved on a permanent basis.

The following information summarizes the results of our work. Our responses to your specific questions are contained in appendixes II and III.

REA's Proposal to Eliminate Its Engineering Standards Divisions

In late 1984, REA explored the possibility of shifting responsibility for developing its electric and telephone standards to the private sector. In further clarification of REA's actions, REA's Administrator, in April 1985, said that REA was reviewing whether a need still existed for government involvement in the electric- and telephone-engineering standards functions. REA's organizational entities that would be affected by a change in performing the standards functions include its Engineering Standards Division (which develops and maintains engineering standards for electric distribution borrowers) and its Telephone Engineering Standards Division (which develops and maintains engineering standards for telephone borrowers).

REA develops and maintains engineering standards for utility cooperatives that obtain REA loan funds. The standards apply to the construction of electric distribution and telephone facilities. As of January 22, 1986, there were 42 REA-developed standards applicable to rural electric distribution borrowers and 47 standards applicable to rural telephone borrowers. According to REA officials, the standards are developed to meet the specific needs of rural electric and telephone utilities and are prepared when acceptable industry standards are not available. When REA develops its standards, existing industry standards are referenced where possible. In addition to developing specific standards, REA also develops, as part of its standards-setting function, a list of acceptable materials to be used in constructing facilities.

REA Engineering Standards Viewed as Beneficial

On the basis of discussions with officials from three private standards-setting organizations—the American National Standards Institute and two rural cooperative associations—as well as two studies completed in January and March 1985 of REA's standard-setting activities, we determined that the advantages resulting from REA performing its standards-

setting function include lower facilities construction costs resulting from standardized designs, materials, and contracts; greater security for REA loans due to standardized construction methods; and increased efficiency for materials and equipment manufacturers. According to these officials, the advantages far exceed any disadvantages. One disadvantage pointed out to us was that the cost of the standards-setting functions is borne by the government rather than the consumers who benefit from the standards. Also, some officials were concerned that REA may not be supporting voluntary standards-setting organizations as much as it could. According to them, OMB Circular A-119 encourages federal agencies to support and participate with standards-setting organizations to voluntarily develop standards for rural cooperatives.

We also examined whether private organizations would be willing to develop and maintain engineering standards for rural utility cooperatives. Of the five organizations contacted (see app. I, pp. 10-11), officials from three told us that they were unwilling to assume this function. Officials from the other two indicated that their respective organizations could possibly assume REA's standards-setting functions—one for electric borrowers and the other for telephone borrowers. However, neither of these two organizations nor the other organizations were willing to develop the list of acceptable materials that REA develops. According to REA's internal study of its standards-setting functions, REA's borrowers, construction contractors, and manufacturers of equipment and materials consider this list to be critical.

During our work, REA's Deputy Administrator told us that REA had decided not to pursue implementation of its proposal to eliminate its engineering standards divisions because the Senate report for REA's 1986 appropriations (1) states that no appropriated funds can be used to change the engineering standards divisions and (2) directs REA to fully staff the divisions in order to continue providing the necessary technical expertise to telephone and electric borrowers.

REA's Proposal to Revise Its Criteria for Approving and Dispersing Loan Funds

In late 1983, REA also considered revising the criteria it uses to initially approve loans and then disperse loan funds to electric cooperatives. On October 21, 1983, REA published in the Federal Register a pre-notice entitled "General Fund Criteria for New Loans and Advances." REA applies its general fund criteria as a measure of electric cooperatives' need for REA loan funds to construct electric power generation and distribution facilities and to operate their power systems.

Under REA's current criteria,¹ electric cooperatives can meet one of the qualifications for loan approval or obtain advances on previously approved loans if the amount of its general funds does not exceed a level represented by 8 percent of the value of its power facilities or \$100,000, whichever is greater.² Our Office of General Counsel is currently preparing a response to questions raised by the Chairman of the Subcommittee on Government Information, Justice, and Agriculture of the House Committee on Government Operations and the Chairman of the House Committee on Agriculture as to REA's legal authority to adopt and follow the general funds criteria in determining borrower eligibility. We will forward a copy of that opinion when it is rendered. Under the proposal REA is considering, this loan-approval and funds-advance criteria would require that the value of an electric cooperative's adjusted working capital (generally current assets less current liabilities) not exceed 5 percent of the value of its power facilities. This proposed change would reduce the percentage applied to power facilities by approximately 3 percent.

According to REA officials, the proposal stemmed from (1) a 1983 Department of Agriculture Office of Inspector General report³ which recommended that REA revise its loan-making criteria and (2) REA's view that changes to its loan-making criteria were needed to better match available loan funds to the financial needs of electric cooperatives.

Proposed Loan-Making Criteria Has Some Merit

Cooperative associations, as well as some members of Congress, have expressed concern over REA's proposal to revise its loan-making criteria. The concern generally centers on a belief that implementing REA's proposal would significantly reduce the availability of REA loan funds to electric cooperatives. REA officials believe that its proposed revision would result in matching available loan funds more closely to borrowers' needs for financial assistance.

¹Throughout this report, we will be referring to REA's current general funds criteria for approving loans and advancing funds to its electric cooperatives. The criteria referred to will be REA's general fund criteria spelled out in one of its bulletins and not the criteria set forth in REA's 1986 appropriations

²A cooperative's general funds include cash, temporary investments, special funds, and other selected current assets

³Loan-making Policies for Electric Distribution Cooperatives, Audit Report No. 09613-2-CH, Oct. 28, 1983

Based on our current examination of REA's specific proposal, we generally concur with REA that a determination of adjusted working capital (one of two key parts of REA's proposal) provides a better measure of the amount of funds a cooperative has available to meet its financing needs than REA's current determination of general funds. REA's determination that a financial need exists when a cooperative's adjusted working capital is less than 5, rather than 6, 7, or 8, percent of the value of the cooperative's power facilities (another key part of REA's proposal) was an REA policy determination based on its analysis that, because of their financial conditions, borrowers could absorb a reduction of general funds for operating purposes.

Both REA and NRECA (an organization headquartered in Washington, D.C., and representing approximately 1,000 electric cooperatives) agree that, potentially, at least 70 percent of REA's electric distribution cooperatives would initially not qualify for loan advances under REA's proposed criteria. In comparison, a separate REA analysis showed that between 25 and 30 percent of the cooperatives would not qualify for loan advances under REA's current criteria. While these analyses provide one measure of the potential impact of implementing REA's proposal, the results are based on the financial condition of cooperatives as of a specific date

Regarding longer term impacts, REA estimated that within 6 to 12 months following implementation, many cooperatives needing REA financial assistance would again become eligible to receive loans and advances since they would use their own financial resources to construct projects which would result in their working capital level being reduced below the 5-percent criteria. NRECA officials, on the other hand, believe that many cooperatives would permanently lose their eligibility for REA funds and turn to non-REA financing of construction projects at a greater cost to their ratepayers because the cooperatives would not want to maintain a lower level of working capital.

During our work, REA's Deputy Administrator told us that REA was no longer actively pursuing this proposal since the Senate report for REA's 1986 appropriations precludes REA from making changes to its loan-making criteria during fiscal year 1986.

REA and NRECA Comments and Our Evaluation

Comments on this report were obtained from the Administrator, Rural Electrification Administration, and the Executive Vice President, National Rural Electric Cooperative Association, and are included as appendixes IV and V, respectively.

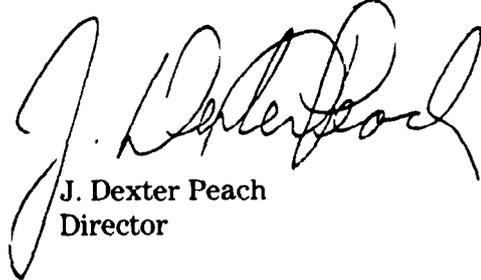
Overall, while REA had no comments concerning the report's discussions relating to REA's proposal to eliminate its engineering standards divisions, NRECA stated its agreement with our findings in this area. Further, regarding REA's proposal to revise its criteria for approving and dispersing loan funds, neither REA nor NRECA commented on the report's discussion of this matter. Rather, both restated their basic views on the proposal. These views were generally provided to us during our work and are included where appropriate throughout the report. Finally, REA commented that the report's comparison of average number of days to process loan applications between the electric program and the telephone program (which is contained in appendix III) was misleading and cited a number of reasons why processing of telephone loan applications takes longer. REA's specific comments are contained in appendix III.

In our opinion, the basic difference in views expressed by REA and NRECA concerning REA's proposed revision to its criteria for approving and dispersing loan funds centers on whether REA's proposal to lower the working capital would result in significantly limiting needed financial assistance for electric cooperatives over the long run. REA maintains that its proposed criteria will more appropriately identify the financial assistance needed by cooperatives over the long run and will assure that such assistance is made available. NRECA, on the other hand, believes the proposed criteria will result in too low a level of working capital that will require many cooperatives to seek alternate higher cost sources of financial assistance to meet their financial needs, and thus result in higher consumer electric power rates and a deteriorating financial condition for many cooperatives. In our view, the long-run impact of REA's proposal is very difficult to predict, given the varying financial situations among the cooperatives and the uncertainty associated with how cooperatives would adjust their financial operations should REA implement its proposal.

Copies of this report are being provided to the Director, Office of Management and Budget; the Administrator, Rural Electrification Administration, Department of Agriculture; the Executive Vice Presidents of the

National Rural Electric Cooperative Association and the National Telephone Cooperative Association; and other interested parties.

Sincerely yours,



J. Dexter Peach
Director

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Abbreviations

ANSI	American National Standards Institute
ASTM	American Society for Testing and Materials
Bellcore	Bell Communications Research
ESD	Engineering Standards Division
EIA	Electronics Industries Association
GAO	General Accounting Office
IEEE	Institute of Electrical and Electronic Engineers
NRECA	National Rural Electric Cooperative Association
NTCA	National Telephone Cooperative Association
OMB	Office of Management and Budget
REA	Rural Electrification Administration
TESD	Telephone Engineering Standards Division
USDA OGC	Department of Agriculture's Office of General Counsel
USDA OIG	Department of Agriculture's Office of Inspector General

Objectives, Scope, and Methodology

In your April 16, 1985, letter you asked us eight specific questions that focused primarily on obtaining information on (1) the advantages and disadvantages of the Rural Electrification Administration's (REA's) engineering standards proposal and (2) the basis for and potential impacts of REA's proposal to revise its criteria for approving loans.

As part of your request, you asked what would be the cost savings/increase attached to (1) the adoption of industry standards and their applications to rural utility systems, (2) the imposition of a user fee for the use of REA standards, and (3) the abolition of all guidelines for engineering standards. In discussions with your office, we pointed out that actual cost data related to these areas was generally unavailable. Your office agreed that further work in this area would not be needed.

Additional information requested from your office or the other Chairmen's offices involved the staffing patterns and costs of REA's standards-setting divisions and the "turnaround" time and the number of loan applications processed during the fourth quarter of fiscal years.

In performing our work, we interviewed officials of REA, the Federal Energy Regulatory Commission, engineering standards-setting or coordination organizations, associations representing utility cooperatives, the Department of Agriculture's Office of Inspector General (USDA OIG), and selected utility cooperatives. We also reviewed appropriate REA documents and internal studies. Our review was made primarily at REA's headquarters and the Washington, D.C., offices of selected organizations and associations.

To evaluate REA's proposal to eliminate its engineering standards divisions, we relied primarily on two studies. One was prepared in January 1985 by Dalton Associates, P.C., consulting engineers, analyzing the cost and benefits of REA's Engineering Standards Division. The other, prepared by an REA in-house team on March 6, 1985, examined all aspects of REA's technical standards-setting program for both the electric and telephone cooperatives. We did not independently verify information contained in the studies but did review documents and records supporting REA's in-house studies that were readily available. We also met with officials of all three of the industry standards-setting groups mentioned in the study—the American Society for Testing and Materials (ASTM), Electronics Industries Association (EIA), and the Institute of Electrical and Electronic Engineers (IEEE)—to obtain their comments on whether the study accurately represented what they said. ASTM, EIA, and IEEE were contacted because REA's in-house study stated that these

groups were representative of nongovernment standards developers. All three groups said that the study adequately reflected their views on REA's standards.

Two other groups we contacted were the American National Standards Institute (ANSI) because of its involvement in coordinating the development of voluntary national standards and Bell Communications Research (Bellcore) because REA officials said that Bellcore was the best organization to contact regarding telecommunications standards.

We also spoke with officials from the National Rural Electric Cooperative Association (NRECA) and the National Telephone Cooperative Association (NTCA), the trade organizations that represent REA's electric and telephone borrowers, respectively. These officials also said that REA's in-house study fairly reflected their views.

To evaluate REA's proposal to revise the criteria it uses to approve loans and subsequently advance loan funds to electric cooperatives, we relied almost exclusively upon documents provided by NRECA, REA, and USDA OIG. We did not discuss REA's proposal with NTCA at any length because REA's proposal applies to loans and advances made only to electric borrowers, not telephone borrowers. We discussed REA's proposal with USDA OIG and reviewed a report USDA OIG had issued in 1983 questioning certain financial practices of REA electric cooperative borrowers that contributed to their qualifying for REA loan advances.¹

To determine whether REA's proposal would minimize the effect cooperatives' financial practices had on qualifying for loans, we assessed how application of the proposed criteria would affect the treatment of various financial accounts of cooperatives. We also obtained NRECA and REA officials' views on the potential effect of the proposal on borrowers' financial practices.

Our work was performed between June and November 1985 and in accordance with generally accepted government auditing standards.

¹ Loan-making Policies for Electric Distribution Cooperatives, Audit Report No. 09613-2-CH, Oct. 28, 1983.

Questions on REA's Proposal to Eliminate Its Engineering Standards Divisions

Question 1

What are the advantages/disadvantages of retaining REA's technical standards-setting function?

Our Response

According to the Dalton and REA in-house studies and discussions with five industry standards-setting or coordination organizations, we found that the advantages of retaining REA's technical standards-setting functions far exceed the disadvantages. These sources identified advantages such as lower costs for constructing cooperatives' facilities, interchangeability of workers and materials among cooperatives, greater loan security, and increased efficiency for equipment manufacturers. A disadvantage associated with retaining REA standards-setting functions, according to these sources, is that the costs of the standards-setting functions are borne by the federal government, rather than those who benefit from the standards. Also, these sources pointed out that retaining the functions seemed inconsistent with overall administrative efforts to encourage and support voluntary standards-setting organizations. A more detailed discussion of the advantages and disadvantages follows.

Advantages of Retaining REA Standards

NRECA requested Dalton Associates, P.C. (private consultants) to study the effects of REA's eliminating its Engineering Standards Division.¹ The study, completed in January 1985, concluded that eliminating or reducing the engineering standards functions at REA would not be productive. According to the study, there are several advantages for REA's retaining the standards-setting functions, including the following:

1. **Lower construction costs.** Mr. Lee Hogan of the Power and Communications Contractors Association testified before the Subcommittee on Agriculture Credit and Rural Electrification, Senate Committee on Agriculture, Nutrition, and Forestry, that the standardization of engineering and contractual requirements by REA has provided, and will continue to provide, lower construction costs to the nation's electric and telephone cooperatives.

¹ REA's engineering standards-setting function for electricity generating and distribution cooperatives is the responsibility of the Engineering Standards Division (ESD). For rural telephone cooperatives, this function is the responsibility of the Telecommunications Engineering Standards Division (TESD).

2. Interchangeability among cooperatives. During times of electric power outages, workers from one cooperative can easily assist another cooperative because power system designs are standardized. Also, since materials are standardized, they can be shared among cooperatives.

3. Help REA meet its mission. As of January 1985, rural electric cooperatives had a consumer density (customers per mile of electric transmission line) that was only 13 percent of that of the investor-owned utilities. Lower construction costs per mile of line—made possible through standardization of materials and contracts—have helped to offset this disadvantage in density. Thus, according to the Dalton study, REA is able to meet the goal of the Rural Electrification Act to provide electric service to rural areas at costs that are not excessive in comparison with investor-owned utilities.

4. Reduction in cooperatives' demand for loan funds. Because the use of REA standards results in lower construction costs, cooperatives do not have to borrow as much from REA. The study estimated that, for fiscal year 1983, REA's engineering standards resulted in savings to electric distribution cooperatives of \$61.5 million to \$110.7 million, which translated to reduced REA loan requirements.

5. Greater loan security. Prior to distributing loan funds, REA requires engineers to certify that construction is completed in accordance with REA specifications and standards and that it meets appropriate strength and safety codes. This certification process provides REA with the assurance that its loans are secure without increasing REA's workload. Without standardization, REA field employees would have to inspect each completed facility and possess an expertise in various construction and design methods, which many do not have.

6. Increased efficiency for equipment manufacturers. Dalton Associates determined that equipment-manufacturing firms also benefit from REA standards in that costs are less to manufacture a single product to satisfy the requirements of about 1,000 cooperatives than to modify that product to comply with the specifications of individual cooperatives.

7. Use by other federal agencies. According to the Dalton study, the U.S. Army Corps of Engineers, the Department of Defense, the Department of Energy's Western Area Power Administration have all relied on REA standards. In addition, the Agency for International Development has relied on REA standards in its overseas electrification efforts.

At the request of REA's Administrator, an internal REA study evaluating the need for its standards-setting divisions was performed. The study, dated March 6, 1985, cited many of the same advantages mentioned by the Dalton study regarding benefits to borrowers, the federal government, contractors, and equipment manufacturers.

In addition to our review of the above studies, we contacted representatives of three industry standards-setting organizations familiar with REA's engineering standards—the Electronics Industry Association, the American Society for Testing and Materials, and IEEE—as well as Bell Communications Research and the American National Standards Institute to obtain their views on the advantages and disadvantages of REA's engineering standards-setting function. Representatives of the groups said that REA's standards-setting functions are beneficial and cited many of the advantages listed in the Dalton study and the REA internal study.

Bellcore and IEEE officials said that the REA standards are more detailed than industry standards and no one in industry is equipped to deliver the same type of standards or design specifications. For example, REA standards advise its utilities on how to select equipment, design specific structures, and perform work uniformly on similar projects. ANSI described how REA worked with the Insulated Cable Engineers Association to develop industrywide standards. All agreed that REA's cooperation is important to them and that REA would continue to need staff to provide input to any standards-setting group or groups that assumed its role.

Disadvantage to Retaining REA Standards

On the basis of our review of the above-discussed studies and conversations with individuals from the industry standards-setting organizations, we determined that one disadvantage to retaining REA standards is that the government bears the cost of developing and maintaining the standards and not the consumer, who primarily benefits from REA standards. According to REA figures provided to Dalton Associates, the estimated expenses of REA's Engineering Standards Division for fiscal year 1984 were approximately \$1.4 million. Of this amount, about \$595,000 represents costs associated with developing and maintaining REA standards for electric power cooperatives.²

²The estimated cost for REA's Telephone Engineering Standards Division standards functions in fiscal year 1984 was \$1.3 million. REA's estimated cost applicable to telephone standards-setting functions in fiscal year 1984 was \$340,000 of this total.

According to the sources we contacted, one concern about retaining REA standards is that REA's retention of its standards-setting function seemed inconsistent with overall administrative efforts to encourage and support voluntary standards-setting organizations. According to an Office of Management and Budget (OMB) Circular A-119, federal use of voluntary standards, whenever practicable and appropriate, reduces the cost of developing and using standards and, thereby, serves the public interest. Consistent with its circular, OMB encourages federal participation in supporting and participating with voluntary standards-setting organizations to develop standards for rural cooperatives.

A representative of ASTM told us that REA, by not relying on voluntary standards-setting organizations to develop and maintain some of its standards, may not be complying with the circular as fully as it can. This representative further said that approximately 1,000 Department of Defense standards have been converted to ASTM standards and that REA could rely on ASTM in the same way.

Question 2

Would adoption and application of industry standards be an acceptable alternative to REA standards?

Our Response

On the basis of our review, it appears that adopting and applying industry standards would not be an acceptable alternative to REA's standards. REA's standards are basically procurement standards whereas most nongovernment standards-setting organizations have developed thousands of standards defining testing, safety, and terminology. REA's standards are different in that they address construction design or specifically address how component parts should be assembled for application on a rural telephone or electric system. While REA currently requires its borrowers to comply with selected industry-developed engineering standards, e.g., ASTM or IEEE standards, none of the officials from ASTM, EIA, IEEE, Bellcore, or ANSI that we contacted said that they develop and maintain standards as specific as those developed by REA. Two of the organizations we contacted—one in the telephone standards area and one in the electric power standards area—indicated, however, that they could possibly assume most of REA's standards-setting functions. Officials from the other three organizations told us that their organizations were not willing to assume REA's standards-setting functions. In addition, none of the five organizations were willing to develop a list of acceptable materials, a component of REA's standards-setting functions that REA borrowers, contractors, and manufacturers consider critical.

In the telephone standards area, Bellcore, a telephone standards-setting organization, currently develops and maintains telephone standards. While Bellcore develops standards for equipment and construction, its standards are designed specifically for Bell's operating companies and not for rural use. Bellcore officials told us that Bellcore could probably assimilate REA's standards function into its standards work with relative ease; however, the decision as to whether or not it would develop REA standards rests with its board of directors. These officials were unsure of the costs that would be involved if the board did approve, but they felt that they would not be too exorbitant.

In the electric standards-setting area, an ASTM official told us that ASTM would be willing to take over the development and publication of REA standards in the electric area—except for the development of REA's "List of Acceptable Materials." An ASTM official said that ASTM could easily establish a voluntary committee for rural electric standards at no cost to the federal government. According to this official, ASTM's administrative and publishing costs applicable to assuring REA's standards-development function would be covered by subscription fees charged to anyone wishing to obtain the standards. Costs for REA staff that would be needed to assist ASTM in developing and maintaining the standards would not be included. In addition, this official added that REA would still need to carry out testing of materials since ASTM does not have sufficient funds to continue this activity. Accordingly, these costs would also not be included in the subscription fee charged by ASTM

Question 3

If REA technical standards are retained, could a user fee be imposed in a practical manner?

Our Response

It would be impractical for REA to impose a fee to all users of its engineering standards but a fee charged to the cooperatives, as a percent of the loans they receive, appears practical. There is some question, however, regarding REA's authority to impose a user fee. Several REA and other organizations' officials we contacted were concerned about how difficult it would be for REA to identify beneficiaries and prorate fees for the costs of REA's engineering standards functions to all users

According to the U.S. Department of Agriculture's Office of General Counsel (USDA OGC), the Rural Electrification Act would have to be amended to provide REA authority to impose a user fee applicable to the use of engineering standards it develops. In a memorandum to REA's

Regional Inspector General for Audit, USDA OGC stated that "Section 306 of the REA Act expressly prohibits such charges." USDA OGC also stated that

"It is abundantly clear from the legislative history, then, that Congress in no way intended any agency to pass on its administrative costs with regard to any program it administers to those it regulates, unless a specific special benefit accrues to a particular beneficiary. Thus, the general expenses REA incurs in continuing its agency existence are not chargeable to REA borrowers."

Our Office of General Counsel is also examining whether REA has authority under existing statutes to impose user fees as part of its response to questions raised by the Chairman, Subcommittee on Government Information, Justice, and Agriculture, House Committee on Government Operations; and the Chairman, House Committee on Agriculture. This information will be included in our opinion (see p. 4) addressing the validity of REA's general funds policy.

Although some officials of the various organizations we contacted believed that a fee for REA services could be practically assessed to REA borrowers, they were concerned about how REA would assess a user fee if applied to all users. Their concern centered on how groups who benefit from REA standards, including cooperatives, would be identified and, once identified, how the fees would be prorated. According to these officials, a number of groups that benefit from REA standards—cooperatives, consultants, contractors, and others—already pay a subscription fee for bulletins and updates on the "List of Acceptable Materials," two types of REA standards documents. The fees cover REA's printing costs but not the costs associated with developing and maintaining the standards. One REA official said that whatever fees would be charged to the different groups would ultimately be paid by the cooperatives' consumers through higher rates the cooperatives would charge for such services.

According to REA's study, many of the cooperatives indicated that they would be willing to pay for REA's benefits as long as the fees were reasonable. Many expressed reservations, however, as to whether such fees could be equitably charged.

According to the Dalton study, REA's engineering standards resulted in savings to electric distribution cooperatives of \$61.5 million to \$110.7 million for fiscal year 1983. Since the estimated costs of REA's standards program are under \$2.7 million, it appears reasonable that an REA fee

charged the cooperatives for costs associated with developing and maintaining its standards would be much less than the benefits the cooperatives receive from these standards.

The administration's fiscal year 1987 budget has proposed that a user fee be charged the cooperatives for REA's administrative expenses. The expenses would include REA's costs associated with developing and maintaining its standards. In this regard, the administration is planning to propose an upfront fee of 5 percent on REA loans that will be used to pay for REA administrative expenses.

Question 4

How would abolishing all technical standards affect REA's program to assist rural utilities in providing electric and telephone service?

Our Response

It appears to us that abolishing all technical standards would have an adverse affect on REA's program to assist rural utilities because the advantages described in appendix II (response to question 1) would be lost. If there were no REA or industry standards, officials of the standards-setting organizations and others said that a decline would eventually occur in the quality of materials and construction of facilities. The utility construction industry supports REA standards and said that the standards enable it to construct lines for about 5 to 9 percent less than comparable construction for other segments of the industry. According to the industry, the savings realized from having standards reduces the demand for financing and helps to hold down rates to consumers but would be lost if standards did not exist.

A study performed for the Edison Electric Institute by an international standards consultant estimates that private utilities save customers 10 times what it costs to perform its standards-setting function. The consultant believes that REA should realize the same savings as private utilities. According to the consultant, standards enable the cooperatives to have their projects competitively bid, which should result in a minimum of 20 percent in savings. The savings are then passed on to the members of the cooperatives through lower charges for electricity and telephone service.

According to the Dalton study, if REA standards were abolished, low-quality equipment and poor plant design would begin to appear in rural areas. REA's internal study pointed out that abolishing REA standards would probably create additional work for REA because staff engineers would have to review construction designs with greater scrutiny to determine if they are safe and cost efficient. This situation, according to the study, could lead to increasing staff needs for REA.

Similar views were expressed by industry officials, as follows.

1. An official of the Power and Communications Contractors Association said that abolishing all standards would adversely affect the industry as a whole because it would create higher costs for labor and material, and costs would be passed on to the consumer.
2. National Telephone Cooperative Association officials said that abolishing all standards would lead to increases in engineering and installation costs. Systems would deteriorate, loans would be jeopardized, and REA would experience increases in its program costs.
3. A United States Telephone Association official said that abolishing standards would result in the loss of competitive bidding which, in turn, would cause loans and costs to increase quickly.

Question 5

What are the staffing patterns for both standards-setting divisions of REA and the costs associated with their functions?

Our Response

According to information provided by the directors of REA's two standards divisions, the approved staffing pattern for both standards divisions stayed at the same level from fiscal year 1983 to fiscal year 1985 (see table II.1). Actual staffing declined during this period, and most of the vacancies occurred in the engineering positions. In fiscal year 1985, the actual staffing of the electric Engineering Standards Division was about 7 percent below its approved staffing level.

**Appendix II
Questions on REA's Proposal to Eliminate Its
Engineering Standards Divisions**

**Table II.1: REA Staffing Levels for Its
Two Standards Divisions**

	TESD			ESD		
	FY 83	FY 84	FY 85	FY 83	FY 84	FY 85
Approved staffing level	32	32	32	28	28	28
Actual staffing (Nov 1st)	28	28	25	28	27	26
Vacancies	4	4	7	0	1	2
Engineers	(4)	(2)	(6)	0	0	(1)
Branch chief	0	(1)	(1)	0	0	0
Support staff	0	(1)	0	0	(1)	(1)

According to the two directors of REA's standards divisions, REA does not maintain costs below division totals. Therefore, actual costs for the standards functions such as standards development, engineering support, administrative support, and other activities are not available.

We were able, however, to estimate the costs of REA's standards functions for fiscal year 1984 (see table II.2) on the basis of information contained in the Dalton study or provided by the divisions' directors. As shown in table II.2, the estimated total costs of both REA standards divisions in fiscal year 1984 was \$2.7 million. The standards development function for the Engineering Standards Division amounted to about \$594,000, including outside contracts for REA's standards activities, and the standards development function for the Telephone Engineering Standards Division amounted to about \$340,000.

**Table II.2: Estimated Costs of REA
Standards Functions for Fiscal Year
1984**

Function	ESD	TESD
Standards development:		
National Standards Activities	\$ 49,691	\$ 49,677
REA Standards Activities	125,327	188,358
Materials Listing	168,861	101,838
Engineering support:		
Area Office Support (technical and procedural)	288,472	376,716
Technical Support (guidance bulletins)	112,574	267,013
Administrative support: (technical and procedural)	303,863	299,717
Other:		
environmental	81,353	-
fuels	57,167	-
outside contracts ^a	250,000	-
Total	\$1,437,308	\$1,283,319

^aRepresents contract support for REA standards activities

Questions on REA's Proposal to Revise Its Criteria for Loans and Advances

Question 1

Examine REA's proposed new requirement for advancing loan funds, giving consideration to whether the proposal ties loan funds more closely to borrowers' needs and whether the proposal will curtail REA's program of loaning funds to cooperatives.

Our Response

On the basis of our examination of REA's proposal, we generally concur with REA's view that analyzing a cooperative's adjusted working capital (one of two key parts of REA's proposal) is a more appropriate measure of a cooperative's need for working capital than is an analysis of general funds (as is done under REA's current policy). With respect to whether the proposal will curtail REA's loan program, analyses made by both REA and NRECA indicate that at least 70 percent of REA's distribution cooperatives would initially not qualify for loan advances under REA's proposal. In comparison, a separate REA analysis showed that between 25 and 30 percent of these cooperatives would not qualify for advances under REA's current policy. In the longer term, REA believes that, within 6 to 12 months following implementation of its proposal, loans and advances would resume for the typical cooperative that had initially been affected.

Under REA's current policy for advancing loan funds, REA examines a potential borrower's amount of cash and other selected current assets (referred to as general funds) at the time a borrower applies for an advance. If this amount represents less than 8 percent of the value of a borrower's plant assets, the borrower is qualified to receive an advance for completed, approved construction in an amount that would raise the general funds level to the 8-percent criterion. Our Office of General Counsel is currently preparing a response to questions raised by the Chairman of the Subcommittee on Government Information, Justice, and Agriculture of the House Committee on Government Operations and the Chairman of the House Committee on Agriculture as to REA's legal authority to adopt and follow the general funds criteria in determining borrowers eligibility. We will forward a copy of that opinion when it is rendered.

Under REA's proposal, the amount of a potential borrower's adjusted working capital would be examined. In general, this examination would determine the extent to which a borrower's amount of cash and other current assets exceeded a borrower's current expenses at the time the borrower applied for an advance. If this amount represented less than 5 percent of the value of a borrower's plant assets, the borrower would be qualified to receive an advance in an amount that would raise the

adjusted working capital to the 5-percent level (another key part of REA's proposal).

In support of its proposal, REA has stated its view that an analysis of a borrower's adjusted working capital more accurately measures a borrower's need for funds to construct facilities (the basic purpose of REA loans) than does an analysis of a borrower's general funds. In general, it appears to us that a determination of a borrower's need for construction funds should give consideration to the level of funds available to a borrower beyond those needed to meet ongoing expenses REA's current policy does not provide for this consideration as well as REA's proposal would. Beyond a comparison of these two loan-making criteria, we were told by REA and Federal Energy Regulatory Commission officials that lead-lag studies, which would determine the effect that a cooperative's assets and liabilities have on its available cash over a given period of time, could better determine a cooperative's need for funds. However, such studies might cost, in some instances, about \$100,000 per cooperative.

Concerning the proposal's potential affect on the level of funds that could be advanced to cooperatives, REA developed 1983 year-end financial data for 920 of its distribution cooperatives and applied its current and proposed criteria for advancing loans to these data. This analysis showed that about 30 percent of the cooperatives would be ineligible for loan advances under REA's current criteria as compared with about 75 percent of the cooperatives being ineligible under REA's proposed criteria. With respect to loan advance amounts, the analysis showed that potential advances of \$474 million could have been made under REA's current criteria as compared with about \$205 million under REA's proposal. REA also performed this analysis using year-end financial data for 1981 and 1982 with similar results.

In commenting on REA's proposal, NRECA said that the proposal would reduce the number of cooperatives eligible for loan advances from 70 to 30 percent. This estimate is generally consistent with the results of the REA analyses discussed above.

The above assessments indicate the potential initial impacts of implementing REA's proposal. In REA's view, resumption of loans and advances for the majority of borrowers could be expected within 6 months to a year following implementation of the proposal as borrowers' working capital levels decrease as a result of borrowers' financing their power facilities with their own funds. NRECA, on the other hand, believes that

implementation of REA's proposal would result in permanent ineligibility for REA loans for many borrowers because the borrowers would not want to maintain a lower level of working capital.

Question 2

Will the proposed new requirement eliminate manipulation of a borrower's level of general funds as pointed out by the Department of Agriculture's Office of Inspector General?

Our Response

On the basis of our examination of an October 28, 1983, report by the Department of Agriculture's Office of Inspector General, we determined that the proposed new requirement will not prevent, for the most part, a borrower from being able to reduce its level of general funds to qualify for a loan advance. With the exception of a borrower prepaying its wholesale power bill, the other financial practices used by borrowers to reduce their cash level can still occur under REA's new proposal.

As part of its examination of REA loan-making practices, the USDA OIG performed detailed financial reviews of 65 cooperatives' requests for REA loan advances. Based on its review, the OIG questioned 11 different financial practices cooperatives used that reduced their level of general funds, thereby allowing them to request REA loan advances. The OIG considered that \$19.5 million of about \$169 million in advances received by these cooperatives were obtained as a result of the questioned practices.

Seven of the 11 practices cited could be considered poor bookkeeping practices or could have resulted from carelessness and, as such, could continue to occur under any REA loan-making policy.

Three of the 11 practices cited by the USDA OIG are currently accepted practices under REA procedures. These include making payments on REA loans prior to the payment's due date, prepurchasing capital term certificates or stock, and retiring capital investments in the cooperatives that were made by cooperative members. These three practices represented about 47 percent of the total number of instances where, according to the USDA OIG, questionable practices occurred. In our view, these practices, if applied by cooperatives under REA's revised policy, would result in a reduction of adjusted working capital in the same way they currently reduce a borrower's level of general funds. This would occur because these practices involve a reduction of cash, which is considered

under either method of determining an adequate level of working capital.

The remaining practice cited by the USDA OIG involved cooperatives prepaying the costs of electric power that they purchase at wholesale rates and distribute to their customers. According to an REA official, the incentive to prepay a power bill should be eliminated under REA's proposal. Under REA's current policy, some cooperatives were prepaying their power bills and thus reducing their level of cash in order to qualify for an advance. Under REA's proposal, the bill for a cooperative's electric power cost will be considered as a reduction to the cooperative's adjusted working capital, thereby making it unnecessary for the cooperative to reduce its cash level to obtain an advance.

Question 3

What other options have been considered as criteria for making REA loans and advancing funds, and what are their projected effects on the rural electric industry?

Our Response

REA considered at least six options that could be used as criteria for approving loans and advancing loan funds to its borrowers. REA decided on its proposed revision because, in its view, the various options it considered either did not provide an adequate measure of its borrowers' need for financial assistance or would have been too complex and difficult to administer. A brief summary of options considered follows.

Modify Present Policy to Allow Exclusion of Portion of Wholesale Power Bill

This option to REA's current policy would have allowed borrowers to exclude from their general funds level a portion of their wholesale power bill. REA found this option more favorable than retaining its current policy for those borrowers needing large amounts of cash to pay their power bills. However, REA believed such a modification would be too complex to administer and would retain the basic weakness of its current policy, i.e., a general-funds-based criteria for loans and advances does not adequately measure a borrower's financial need.

Five-Year Working Capital Approach

Under this option, REA would determine a borrower's capital requirements on the basis of an analysis of a borrower's operating data over a previous 5-year period. However, REA rejected this option because it believed a historical analysis of operating data would not recognize the possibility of significant changes in a borrower's future capital needs. In

addition, REA believed this criterion would be too cumbersome to implement and administer and would impose a significantly heavier workload on both REA and its borrowers.

Equity Approach

This option would have provided that REA and a supplemental lender determine a borrower's optimal level of equity (the percentage of a borrower's equity to total assets) on the basis of an analysis of the borrower's financial indicators and data. The optimal equity level would be determined at the time a loan was approved and subsequent advances of funds would be based on this level. REA believed that implementing this option would reduce the amounts loaned by REA and increase the equity levels of borrowers receiving REA financial assistance. REA rejected this option because it foresaw difficulties in implementing the option and obtaining borrower acceptance.

Rolling Average Approach

This option considered establishing borrowing criteria on the basis of a "rolling" average of a borrower's amount of its power bills. Under this option, a borrower could exclude from its calculation of general funds an allowance for the borrower's average power bill based on the preceding 12 months. The option also allowed borrowers to accumulate a reserve fund to be used for damage repair of facilities resulting from storms or other natural disasters. REA's basis for rejecting this option was that the option would be administratively burdensome and would not provide for sudden changes in a borrower's financial need.

NRECA's Recommended Approach

NRECA's recommended option was to modify REA's current borrowing criteria by adding the amount of a cooperative's monthly power bill to the maximum general funds level of 8 percent of the cooperative's power facilities. REA officials said that this option did not indicate a borrower's financial need and would place an excessive drain on REA loan funds.

USDA O G's Recommended Approach

In its 1983 report, the OIG recommended that REA establish loan-making criteria on the basis of an analysis of a borrower's working capital over the preceding 12-month period and a borrower's construction plans for the upcoming 2-year period. Under this option, after a loan was approved, loan advances would be made as work contained in the 2-year plan was completed. REA rejected this option because it believed the criteria would be too complex to administer and because the option seemed

to provide for advancing loan funds regardless of a borrower's available level of cash.

With respect to the effects that the above options would have on the rural electric industry, REA officials told us that no formal impact assessments were performed. REA rejected the above options on the basis of its view of each option's overall limitations as discussed above. All the options considered by REA, however, would affect differently the cooperative's eligibility for a loan and amount of loan advances. This would occur because each option would result in a different level of general funds being determined which, in turn, would trigger whether a cooperative would be eligible for a loan and, if so, how much of the loan could be advanced. The options that would result in higher levels of general funds allowed would result in more loans being approved and larger advances being made.

Question 4

What is the "turnaround" time for REA loan applications and how many loan applications are processed during the fourth quarter?

Our Response

During fiscal year 1985, REA headquarters averaged 79 days each on loans it approved to REA electric borrowers and 560 days each on loans to telephone borrowers. This is an improvement over fiscal year 1983, when REA averaged 207 days for approving electric loans and 678 days for approving telephone loans. During this same period, the percentage of electric loans approved by REA in the fourth quarter rose from 15 percent in fiscal year 1983 to 53 percent in fiscal year 1985, and the percentage of telephone loans approved in the fourth quarter rose from 33 percent to 55 percent

REA Loan Approvals

As shown in table III.1, the amount of calendar time REA used to process loans approved for electric borrowers during fiscal years 1983, 1984, and 1985 averaged 207, 170, and 79 days, respectively. During this same period, REA's loan-processing time averaged 678, 643, and 560 days, respectively, for telephone borrowers. To determine loan-processing time, we used computer printouts from REA's Statistical Services Branch that showed when applications were received at REA headquarters and when they were approved by REA's Administrator. For electric loans, the processing time ranged from 7 days to 697 days; for telephone loans, the range was from 24 days to 1,800 days. The figures

for electric loans exclude guaranteed loans because this type of loan is not made directly by REA.

As shown in table III.1, the average number of days to process an electric loan application has decreased significantly since fiscal year 1983. An REA official attributed the decrease to a change in procedures that removed USDA's Office of General Counsel from the loan approval process. This official also said that REA staff took longer to evaluate loans in fiscal year 1983 because funds available for loans were much less than funds being requested by borrowers. This situation required REA to spend more time in evaluating and prioritizing each application.

Table I I.1: Average Number of Days for REA to Process Applications for Loans Approved During Fiscal Years 1983-85

Fiscal year	Average number of days to process loans ^a	Range of days (low/high)
Electric program:		
1983	207	38/697
1984	170	9/597
1985	79	7/416
Telephone program:^b		
1983	678	24/1,603
1984	643	109/1,771
1985	560	126/1,800

^aFrom date application received in headquarters to date approved

^bAverages for telephone program include loans that are completely processed by REA staff for the Rural Telephone Bank, a supplemental source of funding for borrowers

REA, in commenting on our report (see app. IV), said that the telephone program loan processing times were misleading. According to REA, telephone borrowers initially submit an application indicating only the amount and general purposes of a new loan. REA treats this as an "Application on Hand-Not Complete" and REA does not start loan processing until all preloan data are submitted. REA said that our data uses "Application on Hand-Not Complete" as a starting point. If an "Application on Hand-Completed" starting point is used to measure loan processing time, according to REA, the average number of days to process telephone program loan applications would be 401, 386, and 240 for fiscal years 1983, 1984, and 1985, respectively. In developing the telephone loan processing time data shown in table III.1, we relied on data provided by REA which did not distinguish between "not complete" and "completed" applications on hand. We did not verify the above time frames provided by REA.

REA, in its comments, also cited reasons why the time period for processing telephone loan applications is longer than for electric loan applications. These reasons included (1) the fact that telephone loans are usually for future construction, covering a 5-year period, rather than the 2-year period for electric loans, (2) the need to determine whether a borrower qualifies for a loan from the Rural Telephone Bank rather than from REA, and (3) an extra step in the telephone process whereby a "loan characteristic letter" is sent to the borrower setting forth the terms and conditions of the proposed loan, before the loan recommendation is sent to the Administrator.

Fourth Quarter Highest for REA Loan Approvals

Table III.2 shows that a high percentage of REA loans was approved during the fourth quarter of fiscal years 1984 and 1985. In fiscal year 1985, for example, over 50 percent of all loans by both REA's electric and telephone programs was approved during the fourth quarter. In contrast, the electric program had only 15 percent of its loans approved in the fourth quarter of fiscal year 1983. The number of loans approved during the fourth quarter of fiscal years 1983-85, shown in table III.2, was computed by us from monthly REA progress reports.

Regarding the large number of loans approved during the fourth quarter of fiscal year 1985, an REA deputy assistant administrator said that this was due partly to the elimination in August 1985 of the USDA OGC from REA's approval process. It appears that the low percentage approved in the fourth quarter of fiscal year 1983 was due to borrowers' applying earlier for loans in fiscal year 1983. As a result, the loans were approved earlier and, as another REA deputy assistant administrator informed us, allocations were used up earlier, leaving less funds available for loans in the fourth quarter of that year.

Appendix III
 Questions on REA's Proposal to Revise Its
 Criteria for Loans and Advances

Table III.2: Number of REA Loan Approvals by Quarters for Fiscal Years 1983-85

Fiscal year	No. of applications approved each quarter				Total no. of loan applications REA approved during fiscal year	Percent of applications approved during 4th quarter
	1st	2nd	3rd	4th		
Electric program:						
1983	78	67	101	45	291	15
1984	59	42	62	103	266	39
1985	14	26	40	89	169	53
Telephone program:						
1983	15	21	24	30	90	33
1984	10	14	13	34	71	48
1985	3	13	17	41	74	55

Advance Comments From the Rural Electrification Administration

Note GAO comments supplementing those on page 6 in the report text appear at the end of this appendix

See comment 1



United States
Department
of Agriculture

Rural
Electrification
Administration

Washington
D C
20250

APR 08 1986

Mr. J. Dexter Peach, Director
Resources Community, and Economic
Development Division
General Accounting Office
441 G Street, NW, Room 4915
Washington, D.C. 20548

Dear Mr. Peach:

We want to thank you for the opportunity to review the draft report entitled Information on Two Rural Electrification Administration Proposals. Enclosed is a copy of the draft report on which a number of suggested revisions have been identified. These suggested changes help to clarify and make the report more technically correct. In addition to these suggested revisions, we also offer the following comments for your consideration.

1. Appendix III. REA's Proposal to Revise its Criteria for Loans and Advances.

Section 4 of the RE Act authorizes the Administrator "to make loans for rural electrification . . . , for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems . . ." Once operational, the borrower systems need to be financially viable operating systems to permit power delivery on an ongoing basis. What constitutes a level of financial viability permitting successful operation and needing REA funding support has been a question over the years since the REA funds are to be used to finance facilities and not investment accounts.

Recognizing the need to have some limitation, language was placed in loan contracts limiting the level of general funds (i.e. a measure of the cash flow needs that might be equated to financial viability). Over the years, the contractual percentage allowed was lowered in stages from 20 percent of plant to 8 percent of plant.

Prior to the recent limitation imposed on REA by Congress in the Fiscal Year 1986 Continuing Resolution appropriation bill, borrowers were limited as to the calculation of the appropriate amount of a loan application and the amount of advances, i.e. existing net general funds plus the amount requested as a loan advance to a borrower could not total more than 8 percent of plant.

In an Office of Inspector General (OIG) audit of the electric distribution program in late 1983, several borrowers were identified that had prepaid certain of their bills in order to qualify to draw down unadvanced loan funds. The most noticeable bill typically prepaid was the wholesale power bill which in most cases represents more than 65 percent of the revenue dollar. Since the funds that were being drawn down only cost them 5 percent

Appendix IV
Advance Comments From the Rural
Electrification Administration

J. Dexter Peach

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interest, it can be assumed in some instances that the borrowers were reinvesting the funds and earning higher rates of return rather than investing them in facilities.

Recognizing this problem, REA began to examine other criteria to measure what constituted a level of financial viability to support a borrower's ongoing operation. One such measure was the working capital concept. This is an easily understood measure that is used by businesses in general to determine operating cash flow needs. This measure also eliminates the wholesale power bill related problem as well and it could be implemented administratively by the REA through the adoption of a new policy.

Another way to solve the problem of borrowers drawing down loan funds that may not be needed for facilities is to remove the incentive of obtaining low cost 5 percent funds by raising the interest rate for insured loan funds. This solution would require a legislative change to the RE Act.

NOTE Table III.1 now on
page 27

2. Appendix III. Table III.1 Average Number of days to Process Applications, etc. Page 38

The comparison between the electric program and telephone program in this table is misleading as it is currently presented. The electric program uses a different method of reporting applications than does the telephone program. The electric program does not consider and report an application as "on hand" until the borrower submits all required preloan data. In the telephone program, borrowers planning new financing merely submit an application form indicating the amount and general purposes of a new loan. This is recorded as an "Application On Hand - Not Complete." GAO Table III.1 uses this starting date in determining the number of days it took to process a loan in the telephone program. In actuality, REA cannot start processing the application until the borrower has submitted all preloan data at which time REA records it as an "Application On Hand - Completed." If this date had been used as the starting time for purposes of Table III.1, the average number of days to process the telephone loan applications would have been:

1983.....	401
1984.....	386
1985.....	240

These numbers should be substituted for those in the draft report.

In addition to the question of the proper data to use as a starting point, there are other reasons why the telephone average processing time is greater than electric. These include the following (a) telephone loans are usually for future construction, covering a five-year period, rather than the two year period for electric loans, (b) the need to determine whether a borrower qualifies for a loan from the Rural Telephone Bank rather than the revolving fund (RETRF) and (c) the extra step in the telephone process where a "loan characteristic letter" is sent to the borrower setting forth the terms and conditions of the proposed loan, before the loan recommendation is sent to the Administrator.

Appendix IV
Advance Comments From the Rural
Electrification Administration

J. Dexter Peach

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We hope these comments are useful in preparing the final report and would be happy to discuss them if necessary.

Sincerely,



Harold V. HUNTER
Administrator

Enclosure

**Appendix IV
Advance Comments From the Rural
Electrification Administration**

The following are GAO's comments on the Rural Electrification Administration's letter dated April 8, 1986.

GAO Comments

1. Additional comments by REA were generally concerned with clarifying specific facts or statements in the draft report. We considered these comments and made changes where appropriate.

Advance Comments From the National Rural Electric Cooperative Association

Note: GAO comments supplementing those on page 6 in the report text appear at the end of this appendix

NRECA NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
1800 Massachusetts Avenue, N.W., Washington, D.C. 20036
Telephone (202) 857-9500

March 27, 1986

Mr J Dexter Peach
Director
United States General Accounting Office
Washington, D C. 20548

Dear Mr Peach:

We appreciate the opportunity to review your draft report entitled Information on Two Rural Electrification Administration Proposals

NRECA is in agreement with the findings of your audit with regard to REA's engineering standards functions. Your report presents well-reasoned arguments and clear evidence that (a) REA's engineering standards greatly improve Government loan security, reduce construction costs and improve service reliability to rural consumers, and (b) there is no viable alternative to retaining the engineering standards function within REA.

The second matter covered by your draft report is REA's proposal to change its general funds policy. As your draft report points out, the FY 1986 appropriations bill prohibits REA from implementing any general funds policy during the remainder of this year. This action was taken by the Congress in order to prevent REA from making unreasonable use of an administrative rule (general funds or adjusted working capital policies) to accomplish a political objective -- the phase-out of the REA program. I am enclosing a December 11, 1985, letter to Mr Phillip Olson, GAO Project Leader of this audit, which details our concerns regarding REA's proposed adjusted working capital rule.

Once again, I appreciate the opportunity to review your draft report

Sincerely,



Bob Bergland
Executive Vice President

BB:nb

Enclosure



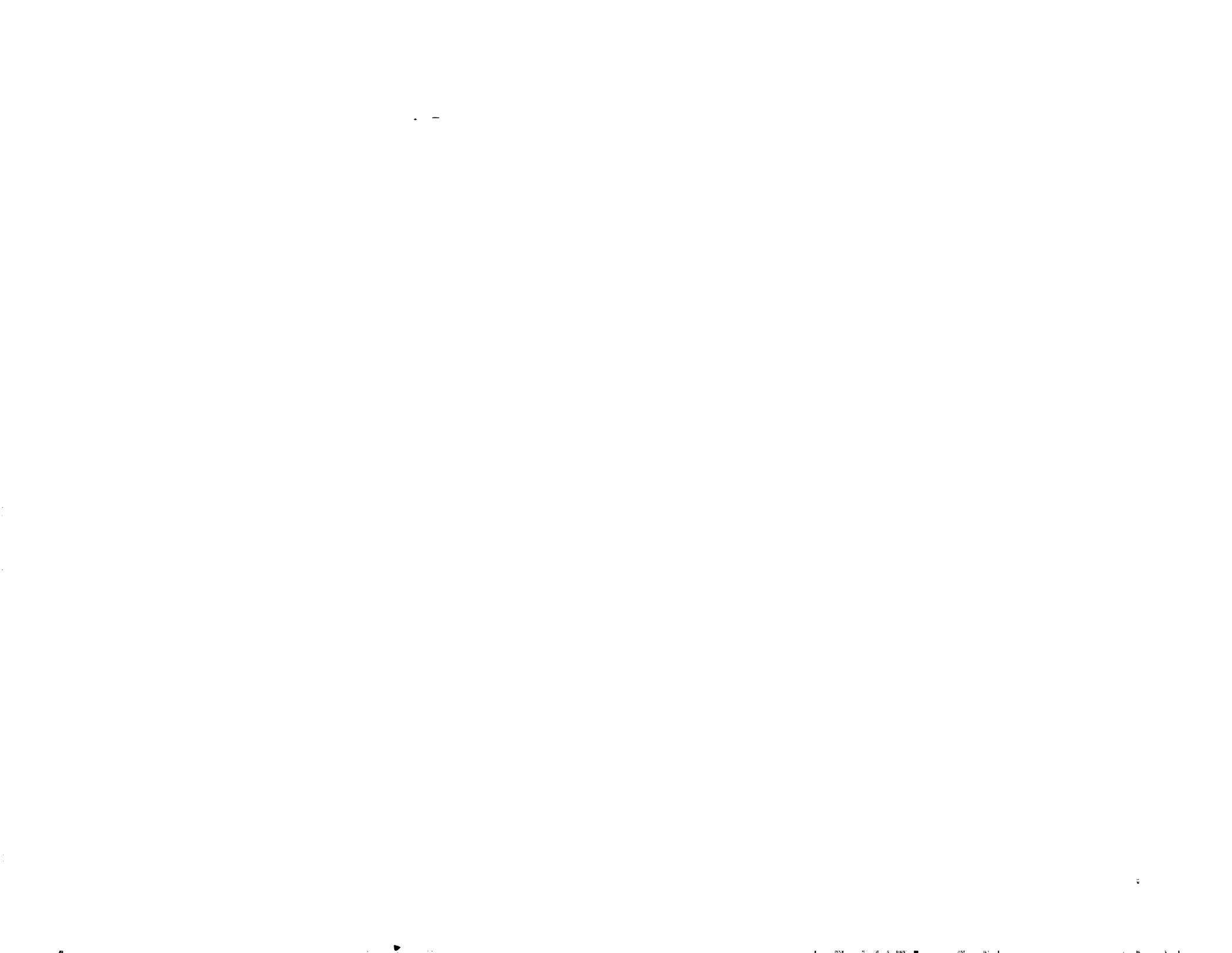
See comment 1

**Appendix V
Advance Comments From the National Rural
Electric Cooperative Association**

The following are GAO's comments on the National Rural Electric Cooperative Association's letter dated March 27, 1986.

GAO Comments

1. The December 11, 1985, letter has not been included in this report since the letter discusses NRECA's comments regarding REA's proposal rather than providing NRECA's comments on our draft report's treatment of this proposal. NRECA's concerns were considered by us during our audit work and are discussed in the report where appropriate.



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