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

INTERNATIONAL DIVISION

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MAY 13, 1982

The Honorable Donald T. Regan
The Secretary of the Treasury

Subject: Misleading Projections For Country Loan Repayment (GAO/ID-82-35)

Dear Mr. Secretary:

Debt service projections for loans administered by the Defense Security Assistance Agency (DSAA), the Agency for International Development (AID), and the Export-Import Bank (Eximbank) are not accurately reflected in Treasury projections. Our analysis for various countries showed that Treasury projections differed from fiscal year 1982 agency projections by 78 percent for AID and 45 percent for DSAA loans. There are differences between Treasury and Eximbank records but the degree of inaccuracies could not be readily determined because Eximbank does not produce a debt-service projection.

As required by Section 634 of the Foreign Assistance Act, Treasury obtains basic data on debts owed to the United States for reporting to the Congress on the value of U.S. foreign assistance loans and guarantees outstanding by category and country. Treasury uses this data also to make debt-service projections. In addition to various offices in Treasury, the projections have been used by the Department of State, Agency for International Development, Office of Management and Budget, and the Congressional Research Service for such purposes as analyzing the economic situation in various countries, making economic forecasts, developing policy options and in preparing budget estimates and congressional presentations. It is, therefore, important that Treasury be able to provide projections which realistically reflect the anticipated repayments due the United States.

During our review of alternative methods to finance foreign military sales, we noted that the Department of Treasury projections of country debt-service requirements were significantly different from DSAA debt-service projections. Accordingly, we performed loan-by-loan reconciliation of DSAA and Treasury data bases. We also interviewed DSAA and Treasury officials to gain an understanding of their accounting procedures and computer programs. We expanded our reconciliation efforts to AID and Eximbank and interviewed officials from these organizations to see if the

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problems found in the DSAA reconciliation were widespread. We did not, however, include loans from all agencies in Treasury debt-service projections for the countries selected. Our inquiry was performed in accordance with the standards for audit of Government organizations, programs, activities, and functions.

The problems inherent in the present method of debt projection by Treasury include

--difficulty in adjusting projections to reflect debt reschedulings;

--erroneous information contained in Treasury's central files; and

--computer controls that exclude loans from data base without a fixed rate of interest, whereas agencies are moving away from fixed-interest rate to variable-rate interest loans.

The following is a brief discussion of each of these problems and our recommendations for improvement. Further details of our findings and the scope and methodologies used in our analysis are discussed in enclosures I and II.

FAILURE TO ADJUST FOR DEBT RESCHEDULINGS

Treasury debt-service projections for countries which have undergone, are undergoing, or are about to undergo debt rescheduling are inaccurate. For example, Treasury overstated 1982 Turkish military debt payments by $190 million because it did not adjust its projections ($210 million) for all of Turkey's debt rescheduling. In another case, AID's rescheduling of Sudan's debt payments was not reflected in Treasury records, even though the rescheduling had been agreed to more than a year before the Treasury projection.

The question of when records should be adjusted to record reschedulings is at the core of Treasury's problem. To make a valid debt repayment projection for a country with rescheduled debt, it is necessary to adjust the loan records by removing interest and amortization payments due during the rescheduling period and rolling this debt into a newly established loan. To be realistic, this adjustment should be done as soon as a rescheduling agreement is reached. However, normal accounting practices would suggest that rescheduled interest payments be rolled over into a newly created loan only after the payments' due dates have passed.

When the reporting agencies provide Treasury with information based on accounting procedures, Treasury (1) overstates payments during the rescheduled period because the old repayment schedule remains on Treasury records and (2) understates payments in its later year projections. This results from future payments not being rolled over into the rescheduled loans in either Treasury or agency records.

In some cases, agencies reported the new loan to Treasury. In these cases Treasury did not cancel projected/previously scheduled principal and interest payments of the old loan. This resulted in overstatement of projected collections during the rescheduled period. However, when DSAA and AID prepare debt-service projections, they manually adjusted their loan records to eliminate the rescheduled payments and add projected interest and amortization payments resulting from the rescheduling.

RECOMMENDATION

Because of the inaccurate debt-service projections resulting from Treasury's current treatment of debt reschedulings, we recommend that the Secretary of the Treasury develop and implement procedures that remove rescheduled interest and amortization payments and roll these payments into a rescheduled loan at the same time the administering agencies adjust their own projections for debt rescheduling. We are not suggesting that reporting agencies alter their current accounting procedures. However, special procedures should be developed for debt-service projections.

NEED TO PURGE TREASURY'S DATA BASE OF ERRONEOUS INFORMATION

Our reconciliation of Treasury's debt-service projection to reporting agency data bases disclosed many examples of erroneous information contained in Treasury's central computer files. These errors cannot be identified through the use of existing computer controls and will continue to plague the quality of Treasury's output unless corrected.

Some of the more common errors found included

--AID loans, repayable in local currency, incorrectly projected by the Treasury as country loans repayable in dollars;

--incorrect last payment dates;

--incorrect repayment schedules;

--missing agency loans committed before the Treasury cutoff date; and

--amortization bases for some Eximbank loans not adjusted to reflect loan sales to other parties and other agency adjustments.

RECOMMENDATION

To improve the quality of Treasury's data base, we recommend that Treasury furnish the data base to reporting agencies for annual verification and reconciliation.

PROBLEMS WITH FLEXIBLE AND VARIABLE INTEREST RATE LOANS

One of the controls built into the Treasury computer is an instruction to skip a loan if the reporting agency fails to provide vital data. These data include such items as interest rates, first and last payment dates, and authorized amounts. If the information is missing, the computer printout will warn the user that a certain number of loans having a set value have been skipped. An example of this problem lies with Federal Financing Bahk/DSAA loans which do not have a fixed-interest rate until the loan is fully disbursed. These loans are skipped by Treasury and excluded in debt-service projections unless an estimated interest rate is inserted in the computer. In the case of Turkey, Treasury skipped five Federal Financing Bank (FFB) loans totaling $254 million because DSAA had not provided estimated interest rates. Technically, DSAA could not provide fixed-interest rates for these loans because they did not exist. To make its own debt-service projections, DSAA estimates composite interest rates and revises them, based on the best available information, before each projection.

Variable interest rate loans also create a problem with Eximbank rescheduled loans, although not nearly of the magnitude created by FFB loans. For rescheduled Turkish loans, Eximbank charged a floating interest rate which will be revised, according to the existing Treasury borrowing rate before each installment due date. For recordkeeping purposes, Eximbank continues to list as the prevailing interest rate the one which was used when the first rescheduled payment was due. However, for billing purposes, the variable rate will be charged. The use of the original interest rate can materially distort estimated interest payments, given the volatile swings experienced in the capital market.

RECOMMENDATION

To overcome the problem with variable interest rate loans, we recommend that the Secretary of the Treasury require reporting agencies to update annually the projected interest rates.

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We have discussed our findings with DSAA, Eximbank, and AID officials and provided Treasury officials with details of the errors found. We would appreciate being informed of the actions taken or planned on our recommendations and would be pleased to discuss these matters with your representatives.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the heads of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs no later than 60 days after the date of this report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretaries of Defense and State; the President of Eximbank; the Administrator, AID; the Director, DSAA; and appropriate congressional committees.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

Enclosures - 2

MILITARY LOAN DEBTS

DISCREPANCIES BETWEEN TREASURY AND DEFENSE SECURITY ASSISTANCE AGENCY

Our comparison of Treasury's records with those of the Defense Security Assistance Agency (DSAA) for selected countries showed significant discrepancies in the amount of debt owed the United States from military-type loans. The degree of these differences is sufficient to question the worthiness of using Treasury's information for decisionmaking purposes.

The comparison was made between Treasury's computer printout of such debt owed by Turkey, Israel, Thailand, and Egypt as of August 31, 1981, with those figures contained in the Department of Defense's Congressional Presentation Document (CPD). We verified the accuracy of the CPD with DSAA supporting documentation and determined that the differences with Treasury records were not attributed to the difference in cutoff dates. The results of the comparison are shown below.

Comparison of Treasury and DSAA Debt Servicing Projections for 1982

Country	DSAA	Treasury	Differences
	(000 omitted)		
Turkey	$ 35,819	$183,346	$+147,527
Thailand	26,459	3,624	-22,835
Israel	595,983	731,105	+135,122
Egypt	142,500	202,500	+60,000

INDIVIDUAL LOAN RECORDS MAGNIFY DISCREPANCIES

To determine how these projections could differ so vastly (more than fivefold for Turkey), we expanded our review to a loan-by-loan comparison and included four additional countries (Liberia, Kenya, Sudan, and Zaire) that were of interest to us in our primary review effort. Although there were 86 loans on DSAA records for the 8 countries, Treasury-projected payments were based on only 32 loans. Forty-five other loans were skipped by Treasury because the computer skips loans if vital statistical information is missing, and nine others were not contained in Treasury records.

The summary reports for DSAA and Treasury differed greatly. For example, Treasury's loan-by-loan projections did not agree with the summary listing they had furnished us. The situation regarding Turkey illustrates the problem. The Treasury summary skipped nine Turkish loans valued at $70.6 million either because of missing information or because the last principal payment was earlier than the projected base date. The loan-by-loan Treasury listing, however, skipped 23 loans valued at $515 million. In fact, only four loans were printed on the second run. Moreover, we found that, for one of these loans, Treasury was understating principal payments by nearly half of the actual amount due.

The problems were not unique to Turkey, which had recently undergone debt rescheduling. Payments on loans for other countries were also skipped because (1) the reporting agency failed to provide the required information or (2) due to the nature of the transaction, sufficient information was not available for Treasury to show the balance. For example, 33 military loans were skipped because the prime rate was missing. Ten of these loans were FFB loans. The prime rate on FFB loans, due to legal requirements, is not determinable until the loan is fully disbursed--often 3 or more years after the loan is authorized.

For some FFB loans, Treasury estimated the composite interest to include principal and interest payments but, in other cases, it did not. Other errors that we found included: incorrect last payment dates, loans authorized before the cutoff date but not included, and incorrect principal repayments.

Further attempts to reconcile

During November 1981, we discussed our findings with the Acting Director of the Office of Data Services, who agreed to provide us with a new listing. The previously missing information would be added and as many other errors as possible would be corrected.

This third listing was significantly improved as to the number of loans projected with only one loan skipped because of missing information. With these adjustments, the differences between Treasury and DSAA debt service actually increased as shown below:

Adjusted Comparison of Treasury and DSAA Debt Servicing Projections for 1982

Country	DSAA	Treasury	Difference
	--------------	(000 omitted)	--------------
Turkey	$ 35,819	$210,982	+$175,163
Thailand	26,459	29,730	+3,271
Israel	595,983	731,108	+135,125
Egypt	142,500	202,500	+60,000
Liberia	2,073	2,298	+225
Kenya	17,702	17,905	+203
Sudan	3,410	8,581	+5,171
Zaire	18,138	18,064	-74

Our analysis of the third Treasury run showed that these differences were the result of:

--Treasury's failure to adjust repayment schedules to reflect rescheduling. (This is due to DSAA's failure to provide the information as well as the incompatibility of the Treasury program to handle debt rescheduling.)

--Different rates of interest used when a loan does not have a fixed rate of interest.

--Different methodologies used in projecting disbursement rates.

--New loans authorized but not yet recorded in Treasury records.

--Continued recording errors not corrected in Treasury's records.

For example, the large difference for Turkey is primarily due to the fact that Treasury's records do not reflect a major debt rescheduling. Treasury continued to show principal and interest payments during 1981 through June 30, 1983, although the U.S. Government had agreed to reschedule the $265 million of interest and principal payments due. The failure to reflect the reschedulings also resulted in Treasury underestimating payments due after the rescheduled period.

Moreover, Treasury is unlikely to ever reduce the rescheduled payments before the actual due date because DSAA only provides Treasury input after the rescheduled payment is due. For example, Treasury's projections included interest and principal payments from a rescheduled loan that consisted of rolled over payments due between July 1, 1980, to June 30, 1981. However, Treasury also continued to show payments from January 1981 forward. Therefore, the payments between January 1, 1981, to June 30, 1981, were projected twice, once under the original loan and once for the rescheduled loan.

Regarding the application of different interest rates, DSAA estimates of FFB loans are generally lower than those which Treasury uses. DSAA will give more weight to the composite rate of previous disbursements, whereas Treasury uses its prevailing borrowing rate. The use of interest rates, which differ by as much as 4 percent, is the major factor in the difference projected for the Israeli debt. Similarly, DSAA used a 9.5-percent interest rate for a $1.5 billion Egyptian loan while Treasury used a 13.5-percent estimate. This resulted in a $60 million difference between the two projections. We did not evaluate the correctness of either Treasury or DSAA interest rates used in the projections. We believe this is a matter that should be addressed in an annual verification and reconciliation of the data base.

The rate of disbursement used also has a profound impact on the estimated payments projected for the earlier years of the loan. Treasury either assumes no future disbursements (outstanding basis) or the loan is totally disbursed when it is authorized (commitment basis). DSAA assumes that 25 percent of the authorized amount will be disbursed in the first year after authorization, an additional 50 percent during the second year, and the 25-percent balance in the third year. To illustrate this point, the comparable projected interest payments for a $175 million fiscal year 1981 Turkish loan are as follows:

Estimated Interest Payments

Fiscal Year	DSAA	Treasury		Difference based on	
		Outstanding	Commitment	Outstanding	Commitment
	(000 omitted)				
1981	$ -	$4,574	$11,240	$ 4,574	$11,240
1982	6,125	9,149	22,480	3,024	16,355
1983	18,375	9,149	22,480	-9,226	4,105
1984	24,500	9,149	22,480	-15,351	-2,020
1985	24,500	9,149	22,480	-15,351	-2,020

Finally, Treasury files for a number of countries contained erroneous data, including three loans with incorrect last payment dates, two loans with incorrect amortization payments, and two loans with incorrect payment schedules. We believe Treasury should purge its files of incorrect data through direct communications with the reporting agency.

DEPARTMENT OF TREASURY DEBT PROJECTIONS DIFFER SIGNIFICANTLY FROM EXIMBANK AND AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECTIONS

Our analysis of the Department of Treasury's debt service projections for loans made by the Agency for International Development (AID) and Eximbank disclosed major differences because Treasury failed to

--reflect debt rescheduling agreements and

--purge its records of erroneous information.

AID LOAN PROJECTIONS

AID produces its own debt-service projections and can provide loan-by-loan support documentation. We used this information for comparison with Treasury's individual loan projections. Because of the volume of loans involved, we limited our detailed analysis to Turkey and Egypt with a cursory review of Thailand and Sudan to determine whether certain problems were widespread.

As of June 30, 1981, Turkey had 139 AID developing loans valued at $1.7 billion and Egypt had 59 loans valued at $3.1 billion. For fiscal year 1982, AID projected debt-service payments of $18 million for Turkey while Treasury projected payments of $89 million. For the same period AID projected dollar payments of $44 million for Egypt compared to Treasury projections of $42 million. These differences were caused by the failure to (1) adjust for debt rescheduling and (2) correct 80 data errors contained in Treasury's central files.

Since 1978, Turkey has been granted four debt service reschedulings. The first rescheduling agreement, signed on December 5, 1978, covered interest and amortization payments from July 1, 1978, to June 30, 1979; the second agreement covered the period from July 1, 1979, to June 30, 1980; and the third rescheduling covered the period from July 1, 1980, to June 30, 1981. The most recent debt rescheduling agreement, signed in September 1981, covers the period of July 1, 1981, to June 30, 1983.

In making the fourth debt-service projection, AID manually adjusted its records to eliminate interest and principal payments rescheduled. On the other hand, Treasury did not adjust for the fourth rescheduling and did not include the loans created by the third rescheduling in its projections. The loans created from the third rescheduling were subsequently added to Treasury records.

While debt rescheduling affects relatively few countries, the failure to purge Treasury records of erroneous information affects many countries. Our comparison of Treasury and AID central files disclosed the following types of problems:

--Treasury overstated dollar debt owed the United States by classifying five Turkish, one Egyptian, and four Thai loans, which are repayable in local currency, as dollar-repayable loans.

--Incorrect terms were used on 24 Turkish and Egyptian loans, such as starting amortization sooner than called for or ending amortization and interest payments later than agreed to by AID.

--Projections of principal repayments for nine fully disbursed loans did not total the outstanding balance of these loans. We informed Treasury officials of this situation and a new computer control was added to notify a customer of this discrepancy.

--Treasury projected equal principal and interest installments when loan agreements called for declining installments with equal principal payments.

The precise cause for some other differences could not be explained. For example, Treasury failed to report fiscal year 1982 to 1988 principal and interest payments for six Egyptian loans. Also, amortization bases for 22 foreign currency loans differed with AID records. Without a reconciliation of the Treasury data base to AID records, these differences will continue.

EXIMBANK PROJECTIONS

Eximbank does not produce a projection of interest and principal payments owed the bank. However, by comparing its Banks Loan Statement to Treasury's Loan Projection we identified several errors in Treasury's data based for the selected 11 countries (Dominican Republic, El Salvador, Honduras, Jamaica, Kenya, Liberia, Portugal, Sudan, Thailand, Turkey, and Zaire).

As with other agencies, Treasury figures do not accurately project debt-service payments to Eximbank for those countries with debt reschedulings. Eximbank, like AID, does not convert principal from the original loan to the rescheduled loan until the payment becomes due. Treasury will still project that these payments will be paid on the original due date when, in reality, they will not be made. The inclusion of this payment on its original due date overstates earlier year repayment projections and understates later year repayments.

Another problem associated with rescheduled loans and debt-service projecting develops over Eximbank's use of a floating rate of interest for rescheduled loans. This rate is based on the cost of money to the Eximbank before each installment. However, Eximbank records the interest rate charged for the first installment as the rate for the life of the loan even though each installment may be charged a different interest rate. This latter interest rate, in turn, is reflected in Treasury's projection and, therefore, the actual obligation is either overstated or understated.

Although Treasury and Eximbank use the same magnetic tape, we noted that Treasury's data still included loans which were paid in full before the maturity date--as was the case with DSAA and AID loans. After we brought this problem to Treasury's attention, they corrected it by installing a new computer control.

The termination of Cooperative Financing Facility loans also creates a problem in Treasury accounts. Treasury will individually list these loans which are often under $1 million each. On the other hand, Eximbank aggregates these loans for each country in their loan statement. When Facility loans are terminated, Eximbank records them in its termination account. We found, however, that Treasury's computer program does not reduce the country balance by the amount in the termination account. Thus, Treasury projections are overstated by the amount of Facility loans terminated. For example, Treasury projections for Facility loans for Turkey were based on an authorized base of $722,000. Based on Eximbank records, projections should have been made on $262,000 which was the difference between Eximbank's authorized $1,063,000 and cancellations of $801,000. The difference between Treasury and Eximbank figures is $460,000.