United States General Accounting Office

GAO

Report to Congressional Committees

October 1994

DEBT SETTLEMENTS

FmHA Can Do More to Collect on Loans and Avoid Losses

GAO/RCED-95-11

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-257647

October 18, 1994

The Honorable Patrick J. Leahy
Chairman
The Honorable Richard G. Lugar
Ranking Minority Member
Committee on Agriculture,
Nutrition, and Forestry
United States Senate

The Honorable E (Kika) de la Garza
Chairman
The Honorable Pat Roberts
Ranking Minority Member
Committee on Agriculture
House of Representatives

In April and December 1992, as part of a special effort to address federal programs that are highly vulnerable to waste, abuse, and mismanagement, we issued two reports highlighting significant risks associated with the Farmers Home Administration's (FmHA) multibillion-dollar farm loan program.[1] This review continues that effort, focusing on FmHA's debt settlements—the agency's process for resolving unpaid direct farm loans. Debt settlements essentially represent FmHA's last chance to collect on loans and avoid losses. This report (1) assesses how well FmHA protects the federal government's interests during debt settlements and (2) provides information on additional FmHA loans made to borrowers after significant amounts of their prior FmHA loans were forgiven—written off as uncollectible—through debt settlement.

This report is based on work performed at FmHA headquarters and state and county offices in Louisiana, Mississippi, and Texas. These states had the largest amount of uncollectible debt written off through debt settlements during fiscal year 1993.

Results in Brief

FmHA is not adequately protecting federal interests during debt settlements; almost $3 billion has been written off during fiscal years 1991-93 without any payments by borrowers. These losses may, in part, reflect the poor financial condition of the borrowers who are subject to the debt

[1]Farmers Home Administration: Billions of Dollars in Farm Loans Are at Risk (GAO/RCED-92-86, Apr. 3, 1992) and Farmers Home Administration's Farm Loan Programs (GAO/HR-93-1, Dec. 1992).

settlement process. However, they also reflect the fact that FmHA's field office officials do not always follow the agency's own debt settlement procedures, which are intended to mitigate the federal government's losses. For example, FmHA's internal reviews, while limited in scope, revealed that field officials frequently do not develop a complete inventory of borrowers' financial resources. As a result, these officials may not be aware of assets or income that could be used to reduce loan losses. Furthermore, even when FmHA has a complete inventory of borrowers' financial resources, it has not always used them to offset losses. According to agency officials, problems in implementing debt settlement procedures stem from various sources, including competing work priorities that create incentives to use the process to "clean up" the delinquent loan portfolio rather than to recover debt.

Borrowers who have benefited from debt relief continue to obtain new loans. In fiscal years 1991 through 1993, FmHA approved new loans totaling $13 million to 86 borrowers who, through debt settlements, had received $20 million in debt relief.

Background

FmHA, a lending agency within the U.S. Department of Agriculture (USDA), provides direct government-funded loans to farmers who are unable to obtain financing elsewhere at reasonable rates and terms.[2] FmHA's assistance is intended to be temporary. Once farmers have become financially viable, they are to "graduate" to commercial sources of credit. FmHA provides loan services through a highly decentralized organization consisting of a national program office in Washington, D.C.; a finance office in St. Louis, Missouri; and a nationwide structure of field offices comprising 47 state offices, about 250 district offices, and about 1,700 county offices.

As we reported in April 1992, FmHA has lost billions of dollars through its farm loan program and billions more is at risk. Our report noted that, as of September 1990, about 70 percent of the agency's direct loan portfolio of almost $20 billion was held by borrowers who were delinquent or whose loans had been restructured as a result of or to avoid delinquency. We concluded that FmHA and the Congress shared responsibility for these problems, which stem from (1) ineffective implementation of standards for loan making, loan servicing, and property management and (2) loan and property management policies, some congressionally directed, that

[2]FmHA also guarantees farm loans made by commercial lenders. However, this report focuses on the agency's direct loans, which are subject to debt settlements.

conflict with fiscal controls designed to minimize risk. We also reported that FmHA's problems will continue until the Congress tells the agency how to better balance its mission of assisting financially troubled farmers with its obligation to provide that assistance in a businesslike and fiscally responsible manner.

Although our previous work examined certain types of loan-servicing actions that result in FmHA's reducing portions of a borrower's debt, we have not, until this report, specifically examined the debt relief provided through the agency's debt settlement process. Under this process, which essentially represents the final resolution of unpaid loans, FmHA county office officials try to identify and evaluate the financial resources a borrower may have that could be used to offset loan losses. Final approval of debt relief is granted by officials in either FmHA's state or national offices.[3] As table 1 shows, FmHA has four options for settling debts, each of which results in writing off debt.

Table 1: Options Available to FmHA in Settling Debt

Settlement type	Description
Adjustment	The debt is satisfied when a borrower agrees to make, at some time in the future, one payment, or a series of payments, that is less than the amount owed.
Compromise	The debt is satisfied when a borrower makes an immediate, single lump-sum payment that is less than the amount owed.
Charge off	The debt is written off without any payment made, and collection activity is ended, but the borrower is not released from liability for the amount owed.
Cancellation	The debt is written off without any payment made, and the borrower is released from further liability because FmHA believes that the borrower has insufficient potential to make additional payments.

Source: FmHA regulations (7 C.F.R. part 1956, subpart B).

[3]During 1993, the Secretary of Agriculture proposed to the Congress a plan to restructure USDA. In early October 1994, the Congress approved a restructuring plan for USDA. This action could change the way debt settlement cases are processed and approved.

Federal Financial Interests Are Not Adequately Protected During Debt Settlements

FmHA forgave billions of dollars in loans through debt settlements without always taking aggressive action to protect the government's interests. More specifically, although FmHA has procedures and policies intended to produce fair recoveries, FmHA's compliance reviews of a limited number of debt settlement cases indicate that field office officials often do not follow these procedures. FmHA officials we spoke with noted that problems in adhering to the procedures stemmed from, among other things, (1) competing program objectives that create incentives to write off large amounts of delinquent loans in an attempt to "clean up" the loan portfolio and (2) limited staff resources.

Most Debt Is Written Off With No Recovery

During fiscal years 1991 through 1993, FmHA wrote off about $3.4 billion worth of outstanding direct farm loans through debt settlements. Table 2, which summarizes the amount of debt written off by settlement type, shows that most of the debt—about $2.9 billion—was canceled or charged off with no payments to FmHA by the borrowers.

Table 2: Debt Written Off by FmHA in Debt Settlements, Fiscal Years 1991-93

Dollars in millions

Settlement type	Number of borrowers whose debt was settled	Debt written off: Amount	Debt written off: Percent
Adjustment	887	$74	2.2
Compromise	3,060	370	11.0
Charge off	4,509	434	12.9
Cancellation	20,975	2,493	74.0
Total	**29,431**	**$3,371**	**100.0**[a]

Note: During this period, FmHA also wrote off an additional $611 million for 4,035 borrowers as a result of bankruptcy rulings.

[a]Percentages do not add to 100 because of rounding.

Source: FmHA.

The amount already written off through debt settlements may be just the tip of the iceberg because FmHA continues to have a large number of problem loans that may eventually be subject to settlement. Specifically, as of January 1994, FmHA classified $7.6 billion—about 45 percent of its $16.7 billion in outstanding principal and interest—as at risk because the loans were held by borrowers with questionable repayment ability and/or inadequate loan security.

Field Offices Do Not Always Implement Debt Settlement Procedures

FmHA has established procedures for its field office officials to use when settling debts. These procedures, intended to reduce losses during the process, include verifying a borrower's income and searching for undisclosed assets. However, FmHA's internal control reviews, as well as our work, indicate that field office officials often do not follow these procedures and thus do not fully protect the government's interests.

FmHA's Coordinated Assessment Review, referred to as CAR,[4] is a key internal control review that includes assessing field office officials' compliance with debt settlement policies and procedures. CARs of debt settlements consist of reviewing a small sample of completed cases, usually five per state. During fiscal years 1993 and 1994 (through May 1994), FmHA completed CARs of debt settlement cases in 15 states. As table 3 shows, the rates of noncompliance ranged from 18 to 39 percent on five key standards intended to protect the government's interests during debt settlements.

Table 3: Results of CARs of Debt Settlements in 15 States, Fiscal Years 1993 and 1994 (Through May 1994)

FmHA's key debt settlement standard	Number of cases in which the standard applied	Percentage of noncompliance
Consideration given to reducing debt relief amount by offsetting other federal payments	56	39.3
Public records searched for undisclosed assets from which collections might be possible	54	35.2
All sources of income verified	48	31.2
Credit report obtained and used to evaluate present and future repayment ability	38	21.1
Current financial information considered in the decision on debt settlement	56	17.9

Note: Because the CARs of debt settlements covered only a relatively small number of cases, the results cannot be projected to all settlement cases and apply only to the sampled cases.

Source: FmHA's fiscal year 1993 and 1994 CAR reports.

Our review of fiscal year 1993 debt settlement cases at six FmHA county offices in three states also disclosed (1) problems with adherence to these five key debt settlement standards and (2) a lack of aggressive efforts to minimize loan losses—that is, FmHA did not pursue information indicating that additional collections could have been possible during the debt

[4]In the CARs, a random sample of loans is examined each year to estimate compliance with FmHA's loan-making and loan-servicing standards. Generally, loans made in about 15 states are sampled and reviewed each year so that each state is reviewed every 3 years.

settlement process. In summary, of the 57 debt settlement cases we reviewed that resulted in large losses,[5] the federal investment may not have been adequately protected in 16, or about 28 percent. In settling these debts, FmHA recovered a total of $5,800 from these 16 borrowers and wrote off $3.7 million. The following cases illustrate these findings:

Case 1. FmHA officials in Louisiana canceled $393,000 in debt with no payment by the borrower without having conducted a record search. As a result, FmHA was unaware of an inheritance of approximately 160 acres in real estate and $61,000 in certificates of deposit that possibly could have been used to offset the loan losses. The lack of a record search was particularly puzzling because the county office's file contained a notation that the inheritance had occurred and a payment to FmHA was possible. County office officials could not explain the note, and state officials said that the failure to protect federal interests had been an oversight.

Case 2. Because of what FmHA state and county officials in Texas described as an oversight, a deceased borrower's $131,000 debt was canceled without the county office's filing a claim with a local probate court. Our review of this case—which included reviewing the probate court's records, comparing the amount of outstanding debt with the value of real and personal property owned by the borrower's estate, and consulting with USDA's Office of General Counsel—disclosed that about $47,000 was available for payment on the debt if the claim had been filed.

Case 3. FmHA officials in Mississippi canceled a $202,000 debt without a payment offer from a partnership consisting of two brothers who reported a total annual income of $123,000 (about $64,500 and $58,500, respectively). Both borrowers submitted documentation claiming that they were unable to repay any part of their FmHA debt because their expenses exceeded their income. Their expense statements included the following information: Both brothers claimed over $15,000 in annual payments to other creditors and expensive gifts to charities; one brother claimed the cost of operating three automobiles, while the other claimed the cost of operating two; and one brother claimed college education costs for his son and daughter-in-law as well as living expenses for that son and his family. FmHA state officials told us that they did not consider these expenses to be excessive, and the supervisor of FmHA's county office questioned whether the agency should require borrowers to lower their standard of living in order to repay their debt.

[5]These cases represent all fiscal year 1993 debt settlements in the county offices we visited that were listed in FmHA's automated records as not involving bankruptcy and that had debt relief of $100,000 or more.

Case 4. FmHA officials in Louisiana canceled $509,000 in debt without offsetting payments that the borrower had received from USDA's Agricultural Stabilization and Conservation Service. These payments averaged $30,000 per year. FmHA made this decision knowing that (1) the borrower's loan defaults could be partially attributed to excessive spending and poor management and (2) the borrower had been referred to USDA for legal action because he had failed to properly dispose of property he had pledged as security for the debt. FmHA state and county officials told us that they had chosen not to use the payments from the Agricultural Stabilization and Conservation Service to offset the loan losses because they did not want to create undue hardship for the borrower.

Limited Emphasis on Minimizing Losses Inhibits Maximum Recovery During Debt Settlements

FmHA has placed little emphasis on minimizing losses during debt settlements. FmHA's approach is illustrated in part by internal performance goals that create work priorities and incentives that are counter to aggressive protection of the government's interests. Specifically, FmHA's field office staff have annual performance goals for resolving delinquent loan accounts, but they do not have balancing goals that would encourage recoveries through the debt settlement process. As a result, several officials at FmHA's state and county offices noted that protecting the government's interests is not a high priority among staff. Also, officials at FmHA's national and field offices said that debt settlements are used primarily to "clean up" the loan portfolio by writing off delinquent debt.

FmHA's management has also placed little emphasis on overseeing field offices' implementation of the agency's policies and practices for ensuring maximum recoveries. In fact, the debt settlement process was not part of internal control review through CARs until 1993. Also, 13 of the 34 CARs of debt settlements scheduled for fiscal years 1993 and 1994 were not performed because of other higher-priority work.[6]

According to several officials in FmHA's state and county offices, insufficient staff resources also inhibit implementing the agency's policies and procedures on debt settlements. We did not verify the extent to which staffing was a problem. However, an official in one state office said that county offices do not always have adequate staff to complete all assigned

[6]In March 1993, the Secretary of Agriculture directed that borrowers whose delinquent accounts were the subject of formal actions to demand loan repayment or obtain property pledged as security for loans would be provided with an opportunity to have their cases reviewed to determine if they had been treated fairly. In April 1993, the acting FmHA Administrator suspended the CARs, and the loan-servicing staff who worked on the CARs of debt settlements were diverted to work on case reviews resulting from the Secretary's directive.

duties and, as a result, are unable to give proper attention to some activities, including protecting the government's interests when settling debts. Also, the supervisor of a county office said that the office's limited staff resources are targeted more toward eliminating delinquent accounts than toward protecting the government's interests during debt settlements.

Borrowers Who Receive Debt Relief Continue to Obtain FmHA Loans

The lending criteria that FmHA follows in making farm loans expose the agency to potential losses. Specifically, the Consolidated Farm and Rural Development Act of 1961, as amended (P.L. 87-128, Aug. 8, 1961), which provides FmHA's basic authority for making and servicing farm loans, does not prohibit borrowers who receive debt relief through debt settlements from obtaining additional farm loans.

We identified borrowers who obtained new FmHA farm loans after benefiting from debt relief through debt settlements. Specifically, during fiscal years 1991-93, 86 borrowers, who had received about $20 million in debt relief when their accounts with FmHA were settled, obtained about $13 million in new direct or guaranteed loans.[7] For example, one borrower who went through debt settlement in April 1991, receiving $500,351 in debt relief, subsequently received a direct loan of $25,100 in April 1993.

Our review showed that some borrowers who obtained additional loans after receiving debt relief through debt settlements became delinquent again. Specifically, although their loans were relatively new—1 to 3 years old—six of the 86 borrowers had already become delinquent again. The following examples illustrate this cycle of delinquency. A borrower who received $278,318 in debt relief in December 1990 obtained two new direct farm loans totaling $65,000 in February 1992; he was $4,087 behind on payments in September 1993. Another borrower, after receiving $1.9 million in debt relief in March 1991, obtained a $120,000 guaranteed loan in September 1991; he was $9,467 behind on payments in September 1993.

Concerns over providing new loans to borrowers who have defaulted on previous FmHA loans are not new. For example, in our December 1992 report, we pointed out that FmHA made about $93 million in loans to borrowers who had received large amounts of debt relief under loan-servicing actions other than debt settlements. Such lending practices have been justified on the basis of the agency's responsibility to help

[7]Seventy-six other borrowers received about $26 million in debt relief through bankruptcy and then obtained about $10 million in new loans from FmHA.

financially strapped farmers remain in farming. However, as we have also previously reported, FmHA has another, sometimes conflicting responsibility—to be fiscally prudent and protect the taxpayers' dollars. Lending to borrowers who have defaulted on previous loans undermines the agency's responsibility in this area. These lending practices can also detract from FmHA's overall mission of assistance because they encourage farmers to rely on FmHA as a continuous source of credit rather than a temporary one.

Conclusions

Billions of dollars in FmHA loans has been written off with little or no recovery under debt settlements. In some respects, these losses are not totally unexpected because FmHA's loans are targeted to borrowers who are financially stressed. By the time a borrower's financial situation has deteriorated to the point that debt settlement may be an option, the borrower may have few resources that could be used to offset potential loan losses. However, FmHA does not take sufficient action to identify and recover payments from those with the resources to reduce their debts. FmHA's internal control reviews as well as our own work indicate that FmHA's field offices often do not implement the agency's procedures and policies intended to protect federal interests during debt settlements.

FmHA's management has provided few incentives for the field offices to aggressively implement debt settlement procedures. The agency does not have performance goals that would encourage the field offices to maximize recoveries during the debt settlement process. However, it does have goals for reducing the levels of delinquent debt. As a result, field offices may view debt settlements more as a means of cleaning up their loan portfolios than as a final opportunity to minimize loan losses.

Additionally, we question the reasonableness of FmHA's making new direct loans and providing loan guarantees to individuals whose past performance resulted in significant losses through debt settlements. We recognize that some borrowers may find themselves subject to the debt settlement process for reasons beyond their control (e.g., crop losses due to a natural disaster). Our concern is not with these borrowers but rather with those whose own action or inaction resulted in their failure to repay loans.

Overall, the problems we found with debt settlements are symptomatic of a much larger, more fundamental problem that we highlighted in our April and December 1992 reports: The agency's congressionally defined mission—to lend money to farmers who cannot obtain loans elsewhere—often conflicts with normal fiscal controls and policies designed to minimize risk and reduce losses. Until the Congress clarifies how FmHA should better balance these conflicting missions, problems similar to the ones we describe in this report will continue.

Recommendation to the Secretary of Agriculture

To provide FmHA's field office officials with incentives to better protect the federal government's interests during the debt settlement process, we recommend that the Secretary of Agriculture direct the FmHA Administrator to establish goals for maximizing recoveries on outstanding loans being resolved through debt settlements.

Recommendation to the Congress

To strengthen FmHA's loan-making standards, we recommend that the Congress amend the Consolidated Farm and Rural Development Act to prohibit direct loans and loan guarantees to borrowers whose accounts were previously settled through debt settlements except in cases in which these borrowers were unable to repay their loans through no fault of their own. The Congress should require the Secretary to (1) establish guidance describing the circumstances under which the exception would apply, (2) closely supervise the borrowers who receive new loans under this exception, and (3) require these borrowers to move to commercial credit within a specified time period.

Agency Comments

In commenting on a draft of this report, FmHA pointed out that we had reviewed a very small sample of debt settlement cases and that conclusions based on such a sample may be questionable. We appreciate the limitations of conclusions drawn from small samples. However, our conclusions are not based solely on information obtained through the cases we reviewed. Rather, these cases are only one of several indications of the problems that form the basis for our concerns about the debt settlement process. For example, FmHA's own internal control reviews identified problems similar to those found in the cases we examined. Limited recoveries under debt settlements are another reason for concern—almost $3 billion has been written off in recent years without any payments being made by the borrowers. In short, we believe that there is sufficient reason to raise questions about how well the federal government's interests are protected in debt settlements.

FmHA generally agreed with our recommendation to establish goals for maximizing recoveries during debt settlements but was not clear about how this recommendation will be implemented. In line with the intent of the recommendation, FmHA noted that USDA's Loan Resolution Task Force, established to resolve delinquent loans, has developed a process designed to ensure that debt settlements are properly implemented through centralized management. This process was scheduled to go into effect in October 1994. FmHA also stated that it is working on a new internal review system that will cover debt settlements. It is too early to determine the extent to which these and other proposed actions will address the problems discussed in this report.

An earlier draft of this report contained a recommendation that FmHA prohibit loans to all borrowers who received debt relief through debt settlements. FmHA noted that this prohibition might unnecessarily penalize those individuals who failed to repay their loans for reasons beyond their control. We have revised the recommendation to accommodate such exceptions. However, we would caution against having the exception become the standard mode of operation. Furthermore, as indicated in the revised recommendation, we believe any borrower receiving a new loan under this exception should be closely supervised and required to move to commercial credit within a specified period of time. We recognize that implementing our recommendation to generally prohibit additional loans to borrowers whose past debts have been settled may require trade-offs concerning the program's goal of assisting farm borrowers. Ultimately, the Congress will have to weigh these difficult trade-offs and determine the direction that FmHA should go.

FmHA's specific comments and our evaluation of them are presented in appendix I.

We performed our work between July 1993 and July 1994 in accordance with generally accepted government auditing standards. Our objectives, scope, and methodology are discussed in appendix II.

We are sending copies of this report to the appropriate congressional committees; interested Members of Congress; the Secretary of Agriculture; the Administrator, FmHA; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request.

This work was performed under the direction of John W. Harman, Director, Food and Agriculture Issues, who may be reached at (202) 512-5138 if you or your staff have any questions. Other major contributors to this report are listed in appendix III.

Keith O. Fultz
Assistant Comptroller General

Contents

Abbreviations

CAR	Coordinated Assessment Review
FmHA	Farmers Home Administration
GAO	General Accounting Office
USDA	U.S. Department of Agriculture

Comments From the Farmers Home Administration

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

United States Department of Agriculture
Farmers Home Administration
Washington D.C. 20250

JUL 28 1994

SUBJECT: GAO Draft Report RCED-94-252, "FmHA DEBT SETTLEMENTS: Federal Interest Is at Risk"

TO: John W. Harman
Director
Food and Agriculture Issues
Resources, Community, and Economic Development Division
General Accounting Office

Thank you for giving us an opportunity to address the draft GAO report. Attached are FmHA's comments to the report.

Michael V. Dunn

MICHAEL V. DUNN
Administrator

Attachments

CONCUR:

Associate General Counsel
Office of General Counsel

Director
Office of Budget and Program Analysis

Under Secretary
for Small Community
and Rural Development

FmHA Farmers Home Administration is an Equal Opportunity Lender.
Complaints of discrimination should be sent to:
Secretary of Agriculture, Washington, D.C. 20250

United States Department of Agriculture | Farmers Home Administration | Washington D.C. 20250

JUL 2 8 1994

SUBJECT: FmHA Debt Settlements
Federal Interest Is At Risk
GAO Draft Report B-257647

TO: John S. Cassell
Acting Director
Planning and Analysis Staff

This is in response to the General Accounting Office (GAO) Report B-257647 on FmHA Debt Settlements.

See comment 1.

Table 2, "Debt Written Off by FmHA in Its Debt Settlement Process, Fiscal Years 1991-93," lists a total of 29,431 borrowers that were debt settled. Out of this number, GAO reviewed 57 cases in 3 states: Texas, Louisiana and Mississippi. Of the cases reviewed, 16 were found to have problems. These three states have above average caseloads and have suffered numerous disasters. Drawing conclusions from such a small sample about FmHA's total debt settlement program may be questionable. However, FmHA is taking steps to make improvements that will reduce its losses.

We agree that the Agency should utilize its resources to establish goals for maximizing the recovery of outstanding loans being debt settled. Secretary Espy has given this direction and has established the Loan Resolution Task Force (LRTF) to resolve delinquent USDA loans in an expedient manner, maximizing the return to USDA, provided the resolution is consistent with stated program goals and objectives.

On June 7, 1994, Secretary Espy provided specific instructions on structure and timing regarding the formation of the LRTF. The LRTF has been charged with overseeing, collecting, and resolving Farmer Program delinquent USDA loans in a proper and expedient fashion, beginning with specific delinquent Farmer Programs loans. Secretary Espy has required that this effort become fully operational no later than October 1, 1994. We intend to take all steps necessary to ensure that this timetable is met, and that all FmHA personnel are fully supportive of this effort.

The LRTF has developed a comprehensive, systematic process for properly evaluating the debt settlement process, which will be implemented for applicable delinquent Farmer Programs accounts by the LRTF, effective October 1, 1994. This process will ensure that a borrower's income and financial assets are properly identified and evaluated, offsets of Government payments are properly considered, and that the process itself is properly implemented through centralized management and oversight. Also, FmHA is working on a new internal review system that will include debt settlement and will incorporate GAO's recommendations and suggestions.

See comment 2.

Secretary Espy has forwarded to Congress a plan for reorganizing and streamlining the Department for the express purpose of making more effective use of available resources to address problems of this nature. Even with the prospects of declining budgetary resources, the Secretary is convinced that reorganization combined with modern automation and new operating strategies can address problems of this nature and, more importantly, prevent similar problems from occurring in the future.

Staffing levels remain a concern. The 1995 Budget for FmHA/RDA was based on Departmental reorganization and supported the lowest practical staff year level that would still ensure efficient delivery of farm, housing and rural development programs, as well as the special initiatives of this Administration. Budget levels requested to support these reorganization plans were intensively scrutinized and represent the Agency's best effort to achieve our reorganization goals while maintaining service to customers. Clearly, adequate staffing levels are essential to continuing these efforts and to recovering outstanding loans. However, significant reductions proposed in the Agency's salary and expense budget beyond those recommended by the President will jeopardize supervised credit and reduce loan servicing of current FmHA/RDA borrowers. This will inhibit our ability to recover outstanding loans and will further increase losses to the Government in terms of writeoffs, foreclosures, and defaults.

The Agency is working to improve its accounting system for coding and tracking delinquent accounts. This should assist in speeding up the resolving of delinquent cases.

Further, FmHA and other USDA agencies and other Federal departments are not able to electronically communicate with each other through the use of computers to share financial and other essential information on individual farmers, including FmHA borrowers. FmHA field offices should have the computer capability to obtain client data from other USDA agencies, and current market information for crops, livestock, reports, prices and yields of farm products to enable field office staffs to more accurately project farm incomes of borrowers. An adequate computer system would improve the efficiency of the FmHA staff. USDA needs an Information Sharing System. The Department's Budget requested $90 million in a separate

2

appropriation for the Info Share Project. A separate appropriation was requested in order to assure dedicated funding and strong central control for the design and implementation of a new and efficient automated system to support these programs. The elimination of this line item may result in short term program delivery impacts as the already limited salaries and expense budgets of the involved agencies are further reduced.

See comment 3.

See comment 4.

GAO recommends that Congress amend the CONACT to prohibit direct loans and loan guarantees to borrowers when their accounts were previously debt settled. Such a broad amendment could eliminate the use of the Leaseback/Buyback and Homestead Protection Programs because almost all of these cases require the use of debt settlement. This amendment would increase the rate of migration of people off of farms and out of rural areas. Many failed borrowers, through no fault of their own, have lost all of their assets through natural disasters, fires, disease and adverse economic conditions including prices. They would be unnecessarily penalized by such an amendment. Also, a collection program that would leave borrowers without any means to support themselves would severely hurt other creditors and rural communities, and would increase the demand on public assistance programs.

A large part of FmHA debt that is resolved through debt settlement is accrued interest. A summary of Farmer Programs borrowers on March 3, 1993, showed that 3,913 accelerated borrowers owed $800,842,527 principal and $572,256,703 interest to FmHA. Accelerated interest is 41.7 percent of the total accelerated principal and interest. Increased losses have resulted from FmHA's practice of continuing to accrue interest on non-performing loans. Also, a moratorium on foreclosures such as that imposed in 1983, and on the sale of farm inventories in 1984 and 1990 have increased the cost of holding inventory, increased the depreciation of security and increased the amount of accrued interest that will not be collected. Many large loans ($1 million and greater) made through the Emergency and Economic Emergency Loan programs required little security or repayment ability and were made to both family farmers and larger than family-size farmers. Although these loans are no longer being made to larger than family-size farmers, we anticipate resolution of the existing, outstanding loans to larger than family farmers will result in large loan losses. The CONACT mandates that FmHA release normal income security to delinquent borrowers for the payment of essential family living and farm operating expenses until their accounts are accelerated, even though they cannot make payments on their FmHA loans.

3

Rather than prohibiting loans to delinquent borrowers, FmHA plans a more intensive and increased use of the supervised credit programs. The Agency has a training session on supervised credit scheduled for its personnel in September 1994. Farm recordkeeping, farm planning and analysis, production and financial management supervisory techniques, utilization of farmer program servicing programs, and collection and security servicing methodologies will be featured. The new borrower training program will improve borrowers' skills. The FmHA Finance Office is working on a better coding and tracking system for providing more accurate data on accelerated accounts, bankruptcy, foreclosures, litigation, and etc. This new system will provide management and field staffs with more accurate up-to-date information on problem cases. The LRTF will provide a quicker settlement of debts.

These improvements will reduce delinquency and Government losses while providing borrowers with a better opportunity to continue to farm.

We concur that the Agency's congressionally defined mission -- to lend money to farmers who cannot obtain credit elsewhere frequently conflicts with commercial fiscal standards and policies designed to minimize risks and losses. However, the Agency's traditional loan programs to family-size farmers have provided them with incentive and opportunity to become successful at reasonable costs. These farmers include beginning farmers, socially disadvantaged farmers and farmers that have suffered severe losses through no fault of their own due to natural disasters and unpredictable, adverse economic conditions. These farmers would not have been able to begin farming or stay in farming without these FmHA loans. The maintenance of the family farm system of agriculture is essential to the continued economic and social well being of rural communities and the nation as well as the competitive production of adequate and affordable supplies of food and fiber.

To avoid disrupting our State Offices, we would appreciate your providing FmHA with the names and/or case numbers of the 57 cases that were reviewed.

Lou Anne Kling

LOU ANNE KLING
Assistant Administrator
Farmer Programs

4

The following are GAO's comments on the July 28, 1994, letter from the Farmers Home Administration.

GAO's Comments

1. As discussed in the agency comments section of our report, these cases are only one of several indications of the problems that form the basis for our concerns about the debt settlement process.

2. We updated the report to recognize the Secretary's reorganization plan.

3. FmHA expressed its concern that prohibiting loans to borrowers whose accounts are resolved through debt settlement could eliminate the use of its leaseback/buyback and homestead protection programs. In these programs, borrowers who default on FmHA loans are given preference in reacquiring the farms that they had pledged as security for those loans. FmHA may finance these transactions. Implementing our recommendation would not eliminate these loan-servicing programs—former owners would still retain preference for reacquiring their farms. However, we recognize that it would be difficult for some former owners to take advantage of this preference without FmHA financing.

4. As discussed in the agency comments section of our report, we revised our draft recommendation to accommodate borrowers who fail to repay loans because of circumstances beyond their control.

Objectives, Scope, and Methodology

This review was undertaken as part of a special effort to address federal programs subject to a high risk of waste, abuse, and mismanagement. To gain a complete understanding of FmHA's debt settlement process, we reviewed FmHA's regulations, operating instructions, and other guidance to field offices. We also interviewed officials at the agency's Office of Farmer Programs in Washington, D.C., and at state and county field offices. Computerized program records were provided by FmHA's Finance Office in St. Louis, Missouri, and information on CARs was obtained in the form of summaries of state performance reviews from FmHA's Washington, D.C., headquarters.

For our review of individual debt settlement cases, we used records from FmHA's Finance Office to identify the three states—Louisiana, Mississippi, and Texas—with the largest dollar amounts of debt written off through debt settlements during fiscal year 1993. We then used detailed statistics on borrowers from these states to select the two counties in each state with the highest number of debt settlements. Finally, for the two selected counties, we eliminated all the cases settled through bankruptcy or resulting in a debt write-off of less than $100,000. We reviewed the remaining 57 cases by making field visits to the six county offices to examine files on borrowers, search public records, and discuss debt settlements with county officials to evaluate whether the federal government's interests were adequately protected. We then discussed the results of our case reviews and general debt settlement issues with FmHA state officials and, where necessary, with USDA's Office of General Counsel.

To evaluate the extent of new loans to borrowers whose past debts had been settled, we matched information on debt settlements and loan obligations in data bases provided by the St. Louis Finance Office.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.

Robert E. Robertson, Assistant Director
Patrick J. Sweeney, Assignment Manager

Dallas Regional Office

Reid H. Jones, Evaluator-in-Charge

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested