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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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CIVIL DIVISION

FEB 25 1971

Dear Mr. Smith:

The General Accounting Office has reviewed the practices followed by the Farmers Home Administration (FHA) in establishing and accounting for allowances for losses on uncollectible loans for FHA's various loan programs.

In a report issued to the Congress on improvements needed in FHA's financial statements of the Emergency Credit Revolving Fund (ECRF), B-114873, December 30, 1970, we commented that we were unable to evaluate the reasonableness of the allowances for losses on loans receivable, interest receivable, and judgments receivable as shown in the ECRF financial statements. We pointed out that FHA's accounting system did not provide adequate information on which to base an evaluation of the collectibility of outstanding loans.

During our audit of FHA's financial statements of the ECRF, the FHA Assistant Administrator for Management requested the program directors at the headquarters office to initiate, on a semiannual basis, a review of the percentage rates used to establish allowances for losses for FHA's various loan programs. Although these semiannual reviews have resulted in some changes in percentage rates, the changes were made without the benefit of any input from FHA field office personnel concerning the collectibility of outstanding loan receivables. In our opinion, more realistic percentage rates for establishing allowances for losses could be developed if FHA county supervisors participated in periodic evaluations of the collectibility of outstanding loans and the data collected from such evaluations were used as a basis for establishing the overall percentage rates for the various loan programs.

To demonstrate the extent to which county supervisors could contribute to the process of developing more realistic percentage rates, we obtained certain information from the files in the Finance Office in St. Louis on 100 farm operating loans. The loans were selected on a random sample basis. We mailed questionnaires to the FHA county supervisors responsible for servicing the 100 loans requesting their estimates of the loans' collection potential. We also requested that the county

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supervisors provide us data on the borrowers' delinquency status, estimated income and expenses, and net worth and on the property serving as security for the loans.

The 100 loans had balances outstanding totaling $400,680 at September 15, 1970, as compared to FHA's total farm operating loans outstanding of $703.6 million at that date.

Our analysis of the estimates made by the county supervisors showed that there was an estimated potential for loss of $32,363 on nine loans. Seven of these nine loans were classified as collection-only loans for which all security property had been liquidated. The county supervisors regarded the remaining 91 loans as fully collectible based on present circumstances for the following reasons:

Reason considered fully collectible	Number of loans
1. Borrower's income sufficient to repay loan	17
2. Loan fully secured by borrower assets	21
3. Borrower's income sufficient and loans fully secured by borrower assets	36
4. Loans were paid in full between sample date and response from county supervisor	10
5. Miscellaneous reasons	7
Total loans	91

Consequently, on the basis of the county supervisors' estimates, $32,363 or 8.1 percent, of the outstanding loans of $400,680 included in our sample may be uncollectible.

At September 30, 1970, FHA had established an allowance for losses of $47.4 million on farm operating loans, or 6.4 percent, of the unpaid principal balance for farm operating loans of $743 million. Although the 8.1 percent indicated by our limited random sample may not be representative of the entire program, a differential of even 1 percent in the percentage rate used to establish the allowance for losses for farm operating loans could change the net income reported on the financial statement for the program by over $7 million.

We believe that bringing the knowledge of the county office personnel to bear in arriving at percentage rates to be used in establishing allowances for losses on loans would be an important supplement to the judgments presently being made by FHA officials at the Finance Office and the headquarters office in Washington.

RECOMMENDATION

Until such time as an adequate financial management system is designed to generate necessary data to use in arriving at estimates of losses, we recommend that FHA establish a periodic review process which will utilize the experience and knowledge of the county office personnel in determining the estimated collectibility of loans. This review process could be accomplished in conjunction with the county office's annual review of delinquent and problem loans and collection-only loans. The data accumulated by the field offices could be forwarded to the Finance Office to be analyzed and tabulated for use as appropriate in adjusting the percentage rates used in establishing the allowances for losses for FHA's various loan programs.

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While we plan to do no further audit work relating to FHA's allowances for losses, we would appreciate receiving your comments on our recommendation.

We wish to acknowledge the cooperation extended our representatives during our review. A copy of this letter is being sent to the Office of the Inspector General, Department of Agriculture.

Sincerely yours,

Bernard Sacks

Bernard Sacks
Assistant Director

Mr. James V. Smith, Administrator
Farmers Home Administration
Department of Agriculture