United States General Accounting Office

GAO

Report to the Secretary of Agriculture

January 1990

FINANCIAL AUDIT

Farmers Home Administration's Financial Statements for 1988 and 1987

GAO/AFMD-90-37

GAO

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

Accounting and Financial Management Division

B-226249

January 25, 1990

The Honorable Clayton K. Yeutter
The Secretary of Agriculture

Dear Mr. Secretary:

This report presents the results of our examination of the Farmers Home Administration's (FmHA) financial statements for the fiscal year ended September 30, 1988. Our opinion on FmHA's consolidated financial statements is qualified because we were not able to satisfy ourselves that FmHA's acquired property accounts were presented fairly.

FmHA lost \$13.8 billion in fiscal year 1988. The 1988 loss was partially offset by appropriations of \$7.5 billion. FmHA's accumulated deficit is now \$42.6 billion. The 1988 loss was primarily attributable to net interest expenses of \$6.4 billion and provisions for losses on direct and guaranteed loans of \$5.7 billion. Delinquent farm loan balances were \$12.5 billion or 49 percent of the farm loan portfolio.

This report contains separate reports on FmHA's system of internal accounting controls and on its compliance with laws and regulations. Our report on FmHA's system of internal accounting controls discloses the following material internal control weaknesses related to acquired property: (1) FmHA's loan classification system used to estimate losses on individual farm loans is unreliable, (2) FmHA's Acquired Property Tracking System (APTS) contained inaccurate and incomplete information, (3) FmHA has not completed APTS modifications which would allow it to properly record acquired property at fair market value or to record the associated gain or loss at the time of acquisition, and (4) FmHA has not developed a methodology for determining property holding and disposition cost factors for estimating loan losses and for computing the acquired property balance.

Our report on compliance with laws and regulations discloses that FmHA complied with the provisions of laws and regulations for the transactions we tested.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House

significant internal accounting control weaknesses in the system allow the reporting of inaccurate data. These inaccuracies remain undetected and uncorrected because reports produced by the system are not properly reconciled with detailed acquired property files at FmHA's field offices. Accordingly, in the absence of an accounting system which generates reliable financial data on acquired property operations, we determined it was not practical to perform, nor did we perform, sufficient alternative audit procedures to satisfy ourselves as to the net realizable value of FmHA's acquired property and the associated provision for losses for 1988.

GAO Opinion

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to perform the necessary auditing procedures to satisfy ourselves as to the value of acquired property and the associated provision for losses, the statements of financial position as of September 30, 1988 and 1987, and the related statements of operations and cash flows for the year ended September 30, 1988, present fairly, in all material respects, the financial position of the Farmers Home Administration as of September 30, 1988 and 1987, and the results of its operations and its cash flows for the year ended September 30, 1988, in conformity with generally accepted accounting principles.

As discussed in note 6, the fiscal year 1987 financial statements recognized cumulative adjustments to correct the allowances for loan and interest losses. Because fiscal year 1987 was the first year that FmHA's financial statements were audited, we were unable to determine the amounts of these adjustments pertaining to prior years. Consequently, the full amounts of these adjustments were recognized in the statements of financial position and operations for fiscal year 1987.

The following section provides supplementary comments relating to the impact of the agricultural economy on the financial condition of the Farmers Home Administration.

Financial Condition of FmHA

Over the past 2 years, the U.S. agricultural economy has shown signs of improvement. This is reflected in part by a number of factors, including increased farmland values. The improved financial strength of farmers has led to similar improvements for farm lenders, such as the Farm Credit System and commercial banks, between 1987 and 1988. Loan delinquencies for these lenders have declined, as have the number of in note 12, FmHA estimates it will request $17.3 billion in appropriations to fund realized losses for fiscal years 1986 through 1988.

Donald H. Chapin
Assistant Comptroller General

August 30, 1989

applicable to agency operations are properly recorded to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over agency assets. Because of inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

FmHA annually evaluates its system of internal accounting and administrative controls and issues a report to the Secretary of Agriculture for inclusion in Agriculture's annual FMFIA report to the Congress. In its November 1988 FMFIA report covering fiscal year 1988, FmHA reported that its internal control system, taken as a whole, complied with the requirement to provide reasonable assurance that internal control objectives were achieved. However, FmHA also reported that several material weaknesses existed in its system of internal controls. These weaknesses involved items such as inadequate internal controls over the management and leasing of acquired farm properties and an accounting system which did not completely serve the agency's needs with respect to fundamental accounting and financial control functions.

The 1988 FMFIA report also contained FmHA's annual assessment of its financial management system's compliance with accounting principles, standards, and related requirements for federal agencies. FmHA has one overall accounting system comprised of 13 accounting subsystems. For those subsystems, the assessment identified seven areas which materially failed to comply with the applicable accounting principles and standards. Six of these areas were not corrected as of August 30, 1989. However, FmHA reported that, except for the seven areas noted, the accounting system taken as a whole generally complied with accounting principles and standards.

We considered FmHA's FMFIA reports, the Department of Agriculture's Office of Inspector General reports on financial matters and internal accounting controls, and other GAO reports in determining the nature, timing, and extent of our audit procedures. We also considered the Office of Management and Budget (OMB) staff summary of FmHA's highest risk areas, issued in December 1989. Our study and evaluation of the system of internal accounting controls, made for the limited purpose described in the second paragraph, would not necessarily disclose all material weaknesses in a system. Accordingly, we do not express an

Specifically, FmHA has not completed system modifications which would allow it to properly record acquired property at fair market value or to record the associated gain or loss at the time of acquisition. Moreover, FmHA has not integrated the subsidiary APTS data with the related general ledger control accounts. System modifications to correct these weaknesses were scheduled for completion by September 1989, but have been delayed until October 1990.

Additionally, our tests at 30 FmHA county offices disclosed that APTS contained inaccurate and incomplete information from 24 of these offices because

- acquired properties were not always entered into APTS, while others remained in APTS after they were sold;
- new appraisals, reducing property values, were not recorded in APTS; and
- data entry errors were not always detected and corrected.

Inaccuracies and data entry errors were not detected and corrected because the reports produced by APTS were not reconciled with detailed acquired property records at FmHA's field offices as required by Title 2. Our review noted that county offices in 2 of the 10 states included in our sample did not receive copies of the APTS reports needed to perform the reconciliations. Furthermore, APTS software did not include parameter checks to detect the recording of unreasonable property values. For example, although FmHA regulations generally limit approval of single-family housing loans in excess of $60,000, some single-family houses were erroneously recorded in the system at values exceeding $1 million.

In March 1989, we notified FmHA about the serious nature of the internal control weaknesses in the acquired property accounting system. In an effort to reconcile the information in APTS with source documents maintained at the county offices, FmHA required all county offices to review and correct their records and to certify that the inventory as recorded in APTS as of July 21, 1989, was correct. However, as of August 30, 1989, the agency had not corrected the errors or made the software changes necessary for detecting unreasonable property values.

collateral with no loss reported in the loan classification system. However, a September 21, 1988, appraisal lowered the value of the collateral, indicating a potential loss of about $2.7 million.

Procedural errors by FmHA personnel resulted in inaccurate loss estimates in 64 cases. Although FmHA instructions provide guidance to supervisors for preparing the loan classification system documents, we found that they did not apply this guidance consistently and accurately. For example, our audit procedures disclosed

- a $12 million error was made in calculating collateral liquidation costs because the 20-percent cost factor for holding and disposition costs was incorrectly applied to the loan balance rather than to the collateral value, and
- prior liens were not considered in establishing an estimated loss, resulting in an $86,000 understatement of the estimated loss.

Additionally, we found seven loans in our sample with loss estimates that were omitted from the total loan loss projection in the general ledger. These omissions could have been detected and corrected if a reconciliation between loss estimates in the field office files and automated files in the farm loan classification system at the finance office had been performed as required by Title 2. The remaining 37 cases contained a combination of the above mentioned errors.

Although we found 212 inaccurate loss estimates in our sample of 500, the internal control weaknesses discussed above did not affect our opinion on the fiscal year 1988 financial statements. Many of these errors offset one another, and our statistical projection of the errors and other audit procedures indicated that the fiscal year 1988 loan loss estimates for the farm loan portfolio were not materially misstated. However, as adequate control procedures were lacking, it is only happenstance that the fiscal year 1988 loss estimates were not materially in error.

Holding and Disposition Costs Are Not Based on Sound Methodology

GAAP require that property holding and disposition cost factors which consider historical repair and maintenance costs, as well as current estimates of taxes, insurance, and the cost of capital, be considered in estimating loan losses and in determining the net realizable value of acquired property. FmHA has not developed an appropriate methodology for determining such costs. Instead, FmHA applied a flat 20-percent factor to collateral values to calculate its estimate of $3.5 billion in holding and disposition costs for use in establishing loan loss estimates. FmHA

- Ensure that field office supervisors use market values of collateral as close to the end of the fiscal year as practicable to estimate loan losses in the loan classification system.
- Reconcile estimated loan losses between the field office files and the automated files at the finance office as of fiscal year-end.
- Ensure that field office supervisors follow instructions when calculating the estimated loan losses, particularly the procedures regarding the consideration of prior liens in loss calculations, and the proper application of liquidation costs. One possible approach would be to provide periodic training on loan classification procedures.
- Develop a sound methodology for determining holding and disposition cost factors applied to loan collateral and acquired property by considering historical repair and maintenance costs, as well as current estimates of taxes, insurance, and cost of capital.

Agency Comments

We provided a draft of this report to responsible FmHA officials for comment. They concurred with our findings and have already initiated some corrective actions. For example, they said that FmHA has

- initiated procedures to ensure proper reconciliations of APTS reports to field office files and has made changes within the system to correct the data entry problems we found and
- established requirements to reconcile automated farm loan classification records to field office files on an annual basis.

Further, they stated that FmHA is committed to implementing the remaining recommendations.

Financial Statements

Consolidated Statements of Financial Position

	As of September 30 1988	1987
	(Dollars in Thousands)	
ASSETS:		
Fund Balance with U.S. Treasury	$ 3,343,405	$ 6,987,940
Accounts Receivable (Note 3) Net of Allowance for Losses of $8,237 in 1988 and $6,593 in 1987	36,852	133,757
Interest Receivable (Notes 4 & 6) Net of Allowance for Losses of $4,871,014 in 1988 and $4,279,752 in 1987	739,546	1,001,750
Loans Receivable (Notes 5 & 6) Net of Allowance for Losses of $18,473,501 in 1988 and $14,664,348 in 1987	39,697,111	46,228,186
Investments In Loan Sale Trust Assets (Note 7)	233,275	234,615
Acquired Property (Note 8)	867,941	1,232,758
Other Assets	33,089	31,270
Total Assets	$ 44,951,219	$ 55,850,276
LIABILITIES:		
Accounts Payable	$ 90,539	$ 78,047
Accrued Interest Payable (Note 9)	3,580,859	3,820,891
Intragovernmental Debt (Note 9)	80,154,218	84,641,218
Notes Payable - Investors (Note 9)	670,278	1,042,225
Accrual for Estimated Losses on Guaranteed Loans (Note 10)	1,278,587	764,431
Other Liabilities	109,855	159,517
Total Liabilities	85,884,336	90,506,329
EQUITY: (Note 11)		
Unexpended Appropriations:		
Undelivered Orders	493,916	525,036
Unobligated Balances	11,617	11,839
Invested Capital	1,148,812	1,142,489
Cumulative Results of Operations (Note 12)	(42,587,462)	(36,335,417)
Total Equity	(40,933,117)	(34,656,053)
Total Liabilities & Equity	$ 44,951,219	$ 55,850,276

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Cash Flows

INCREASE (DECREASE) IN CASH

	For Fiscal Years Ended September 30 1988	1987
	(Dollars in Thousands)	
Cash Flows from Operating Activities:		
Interest Received	$ 2,432,661	$ 2,914,345
Interest Paid	(9,203,252)	(9,291,284)
Appropriations Received (Note 11)	574,098	556,806
Appropriations Disbursed	(596,433)	(596,239)
Program Expenses	(383,658)	(285,393)
Other (Net)	224,433	137,801
Net Cash Used in Operating Activities	(6,952,151)	(6,563,964)
Cash Flows from Investing Activities:		
Collections on Loans	3,380,200	4,536,558
Loans Made	(3,493,511)	(3,874,236)
Proceeds from Loan Principal Asset Sales	1,053,975	2,825,121
Proceeds from Sale of Acquired Property	155,344	154,837
Collections Received on Behalf of Investors	30,838	50,772
Payments Made to Investors	(74,550)	(51,884)
Acquired Property Disbursements	(73,698)	(91,195)
Purchase of Loans	(262,015)	(59,123)
Loss Settlement of Guaranteed Loans (Note 10)	(113,486)	(95,704)
Return of Investment - Loan Asset Sale Trust	1,795	0
Net Cash Provided by Investing Activities	604,892	3,395,146
Cash Flows from Financing Activities:		
Borrowings from U.S. Treasury (Note 9)	17,705,000	12,530,000
Payments on U.S. Treasury Borrowings (Note 9)	(15,679,000)	(7,100,000)
Reimbursements for Losses (Notes 11 and 12)	7,554,171	4,413,671
Borrowings from Federal Financing Bank (Note 9)	0	170,000
Payments on Federal Financing Bank Borrowings (Note 9)	(6,513,000)	(535,000)
Payments on Notes Payable (Note 9)	(371,947)	(35,179)
Revolving Fund Appropriations	7,500	0
Net Cash Provided by Financing Activities	2,702,724	9,443,492
Net Increase (Decrease) in Cash	(3,644,535)	6,274,674
Fund Balance with U.S. Treasury, Beginning of Year	6,987,940	713,266
Fund Balance with U.S. Treasury, End of Year	$ 3,343,405	$ 6,987,940

See Note 15 for Reconciliation of Net Loss to Net Cash Used in Operating Activities.

The accompanying notes are an integral part of these financial statements.

Lending Programs

Insured Lending Activities

Farmers Home Administration budgeted lending programs include insured loans. The term "insured" is defined as loans made directly from the revolving funds. These insured loans are available to be pledged as collateral for borrowings from the Federal Financing Bank. Generally, an insured loan is made only if a borrower can not secure adequate credit from other sources at reasonable rates and terms.

Federal law provides for multiple servicing actions to assist financially troubled borrowers. The most significant of these actions include:

Interest Credit Program:
An interest credit agreement is a contractual agreement between FmHA and single family or rural rental housing borrowers to reduce the borrowers' effective interest rate to as low as 1 percent. Eligibility requirements for single family housing borrowers receiving interest credit are reviewed annually. Rural rental housing borrowers receive interest credit for the life of the loan; however, amounts in excess of scheduled repayments may be due to FmHA based on tenants' income levels. Interest income on related insured loans is accrued at the contractual rate on the principal amount outstanding (Note 4).

Debt Set-Aside Program:
The debt set-aside program was implemented during fiscal year 1985. This program provides for setting aside up to 25 percent of a farmer program borrower's total indebtedness to a maximum of $200,000 for 5 years. During the set-aside period, no interest is accrued nor are principal payments required (Note 4).

Rental Assistance Program:
Federal law provides FmHA the authority to provide rental assistance to eligible tenants occupying eligible rural rental housing, rural cooperative housing, and certain labor housing projects financed by FmHA. Rental assistance is the portion of the approved shelter cost (consists of basic or market rent plus utility allowance) paid by FmHA to compensate for the difference between the approved shelter cost and the monthly tenant contribution. Payments made under this program are reported on the Consolidated Statement of Operations as grants and contributions.

Loan Deferral Program:
The loan deferral program allows a delinquent borrower to postpone the payment of principal and interest for up to 5 years. To qualify, a borrower must be unable to pay essential living expenses or maintain the farm property and pay the debts, but must demonstrate the potential to begin debt payments when the deferral period ends. The borrower is not required to pay interest on the deferred interest. Instead, the deferred interest will be repaid in equal installments over the remaining term of the loan. The interest rate at the end of the deferral will be the lesser of the current rate on a similar type new loan or the original rate on the loan.

the borrower must repay cannot exceed the amount of write-down received. FmHA estimates that 16,000 borrowers will qualify for this program.

Net Recovery Buyout Program

If the borrower is unable to show repayment ability using the available servicing options including Debt Write-Down, the borrower will be offered the option to satisfy his loan at the net recovery value of collateral. The recovery value, since it reflects liquidation costs, will be less than the market value of the collateral. Borrowers qualifying for the option will be required to sign an equity recapture agreement. The agreement provides that, if the borrower sells the property which secured the loan within 2 years of the agreement, FmHA will receive the difference between the net recovery value and the current market value. FmHA cannot recapture more than the debt written off.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

Loans and Allowance for Loan Losses

Loans are carried at the principal amount outstanding less an allowance to reflect their ultimate collectibility. The allowance for loan losses is based on historical data (writeoffs, loan settlement data, and acquired property data), an analysis of the agency's loan classification of borrower accounts, and an analysis of current market factors and conditions (to include delinquent and rescheduled accounts).

Accrual for Estimated Losses on Guaranteed Loans

Anticipated losses on guaranteed loans are estimated based on historical data, losses experienced in comparable insured programs, current market conditions, and field office expectations of loan losses. This estimate is reported as an expense, and a corresponding accrual for estimated losses on guaranteed loans is reported as a liability on the Consolidated Statement of Financial Position.

Income Recognition and Reimbursement for Losses

All significant intra-agency balances and transactions have been eliminated in the consolidation. Sources of funds for the three major revolving funds of FmHA (Agricultural Credit Insurance Fund [ACIF], Rural Housing Insurance Fund [RHIF], and Rural Development Insurance Fund [RDIF]) are provided by reimbursement for losses, borrowings from the Federal Financing Bank (FFB), borrowings from Treasury, borrower loan repayments, and loan asset sales. Sources of funds for the Rural Development Loan Fund and Self-Help Housing Land Development Fund are provided solely through Congressional appropriations and borrower loan repayments.

Interest Income

Interest income on loans is accrued at the contractual rate on the outstanding principal amount. The amount of interest income accruing to nonperforming loans (in excess of 90 days delinquent) is reported as an offset to interest income on the Consolidated Statement of Operations. This offset is not included in the provision for losses on accrued interest on loans as reported on the Consolidated Statement of Operations; however, the offset is included as an adjustment to the allowance for losses on interest receivable as reported on the Consolidated Statement of Financial Position.

NOTE 4: INTEREST

The outstanding unpaid loan interest receivable and the related allowance for losses, by entity, as of September 30, 1988 and 1987, follow:

	September 30, 1988 (Dollars in Thousands)			September 30, 1987 (Dollars in Thousands)		
	Loan Interest Receivable	Allowance For Losses (Note 6)	Net Interest Receivable	Loan Interest Receivable	Allowance For Losses (Note 6)	Net Interest Receivable
ACIF	$5,071,905	$4,470,154	$ 601,751	$4,757,631	$3,928,889	$ 828,742
RHIF	235,524	181,328	54,196	217,662	139,316	78,346
RDIF	301,185	218,559	82,626	304,070	210,727	93,343
Other	1,946	973	973	2,139	820	1,319
Total	$5,610,560	$4,871,014	$ 739,546	$5,281,502	$4,279,752	$1,001,750

Interest income on loans is accrued at the contractual rate on the outstanding principal amount. The interest income recognized, consisting primarily of accrued loan interest, by entity, for the fiscal years 1988 and 1987 follows:

	1988	1987
	(Dollars in Thousands)	
Agricultural Credit Insurance Fund (ACIF)	$1,906,753	$2,101,107
Rural Housing Insurance Fund (RHIF)	1,305,785	1,561,015
Rural Development Insurance Fund (RDIF)	365,321	484,091
All Other Entities	720	2,113
Interest on Loans	3,578,579	$4,148,326
Less Interest on Nonperforming Loans	997,267	1,093,355
Net Interest Income	$2,581,312	$3,054,971

As of September 30, 1988, approximately 14,200 borrowers were participants in the debt set-aside program with almost $604,000,000 of principal being set aside. Interest rates on the majority of the related loans ranged from 4.5 to 13.5 percent; however, interest income is not accrued on the set-aside balances.

Interest income for RHIF does not include $1,427,314,280 of interest credit provided to single family housing and rural rental housing borrowers; however, the amount is recognized as other income and the related interest credit program expense is reported in other expenses. The unpaid principal balance of loans receiving interest credit is approximately $19.2 billion.

The unpaid principal balance of nonperforming loans (in excess of 90 days delinquent) is approximately $14.7 billion. Although interest on these accounts continues to be accrued, this interest is not included in the net interest income reported on the Consolidated Statement of Operations.

The following schedule provides the loan principal repayments based on borrowers' repayment schedules.

Loan Principal Repayments By Fiscal Year
(Dollars in Thousands)

Fiscal Years	Principal Repayments
1989	$5,781,192 *
1990	1,921,883
1991	1,837,406
1992	1,748,630
1993	1,619,219
1994-1998	9,202,613
1999-2003	6,810,217
2004-2008	7,668,029
2009-2013	8,227,916
Over 2013	12,837,127
Subtotal	$57,654,232
Guaranteed loans purchased from holders	516,380
Total loans receivable	$58,170,612

* NOTE: The FY 1989 principal repayments include approximately $3 billion of fully matured loans which are due and payable.

In recognition of the diversity of the FmHA portfolio, the following schedules provide the provision and other adjustments made to the allowance for losses by entity for fiscal year 1988:

Allowance for Loan Losses
(Dollars in Thousands)

	Beginning Balance October 1, 1987	Loans Written Off, Net	Provision and Other Adjustments In Allowance for Losses	Ending Balance September 30, 1988
ACIF	$12,176,199	$(1,473,728)	$3,807,169	$14,509,640
RHIF	2,208,366	(290,353)	1,285,035	3,203,048
RDIF	275,947	(14,826)	494,984	756,105
All Others	3,836	(171)	1,043	4,708
Total	$14,664,348	$(1,779,078)	$5,588,231	$18,473,501

Allowance for Interest Losses
(Dollars in Thousands)

	Beginning Balance October 1, 1987	Interest Receivable Written Off, Net	Provision and Other Adjustments In Allowance for Losses	Ending Balance September 30, 1988
ACIF	$ 3,928,889	$(477,631)	$1,018,895	$ 4,470,153
RHIF	139,316	(9,024)	51,036	181,328
RDIF	210,727	(4,580)	12,412	218,559
All Others	820	(88)	242	974
Total	$ 4,279,752	$(491,323)	$1,082,585	$ 4,871,014

With consideration to the state of the agricultural economy and its effect on rural housing and farm property values, FmHA management is of the opinion that the allowance for losses at September 30, 1988, is adequate to absorb future losses inherent in the portfolio at that date. However, considerable uncertainties continue to remain over the agricultural environment. The losses which will ultimately be realized on the loan portfolio are dependent upon the impact of future commodity prices, production costs, land and housing values, and Government agricultural and economic policy.

NOTE 9: LONG-TERM BORROWINGS

The Secretary of Agriculture is authorized by law to "make and issue notes to the Secretary of the Treasury for the purpose of obtaining funds necessary for discharging obligations and for making loans, advances, and authorized expenditures out of the Insurance Funds." This authority is exercised in the event that cash in the insurance funds is insufficient to cover Congressionally approved loan program authority or other liabilities incurred by the funds in maintaining related loan portfolios.

Borrowings from the Federal Financing Bank and private investors are in the form of Certificates of Beneficial Ownership. Certificates of Beneficial Ownership outstanding with the Federal Financing Bank are secured by unpaid loan principal balances and cash. Of the $3,343,405,005 and $6,987,940,236 Fund Balance with U.S. Treasury as of September 30, 1988 and 1987, $2,703,822,547 and $6,281,076,419, respectively, were held in reserve which, with pledged unpaid loan principal balances, served as collateral for borrowings from the Federal Financing Bank. Certificates of Beneficial Ownership outstanding with private investors are secured by unpaid loan principal balances. The long-term borrowings of FmHA as of September 30, 1988 and 1987, follow:

Long-Term Borrowings
(Dollars in Thousands)

	1988	1987
Federal Financing Bank	$ 58,496,000	$ 65,009,000
U.S. Department of Treasury	21,658,218	19,632,218
Private Investors	670,278	1,042,225
Total Borrowings	$ 80,824,496	$ 85,683,443

As of September 30, 1988, about 54 percent of the FmHA's long-term debt is payable over the next 5 years as indicated below:

Fiscal Years of Maturities	Amount Due (Dollars in Thousands)	Outstanding Borrowings (Dollars in Thousands)	Weighted Average Rate
1988		$ 80,824,496	11.61%
1989	$ 22,041,644	58,782,852	12.35%
1990	8,375,644	50,407,208	12.66%
1991	3,398,461	47,008,747	12.53%
1992	5,793,051	41,215,696	12.34%
1993	4,421,708	36,793,988	12.49%
	44,030,508		
1994 - 2006	36,793,988	0	12.49%
	$ 80,824,496		

NOTE 10: ACCRUAL FOR ESTIMATED LOSSES ON GUARANTEED LOANS

FmHA guaranteed loans are authorized through the Agricultural Credit Insurance Fund (ACIF), the Rural Housing Insurance Fund (RHIF), and the Rural Development Insurance Fund (RDIF). The total outstanding guaranteed loan principal on September 30, 1988, was $5,258,976,683 of which FmHA had guaranteed $4,600,845,451. The period of guarantee provided by FmHA may extend 40 years depending on loan purpose.

The guaranteed unpaid principal balance by entity as of September 30, 1988 and 1987, follows:

	1988 Guaranteed Unpaid Principal Balance	1987 Guaranteed Unpaid Principal Balance
	(Dollars in Thousands)	
ACIF	$ 3,618,477	$ 2,068,910
RHIF	17,306	21,457
RDIF	965,062	1,093,968
Total	$ 4,600,845	$ 3,184,335

Conditional commitments to make guaranteed loans have been established in the amount of $447,348,713.

Anticipated losses on guaranteed loans are estimated based on historical data, losses experienced in comparable insured programs, current market conditions, and field office expectations of loan losses. This estimate is reported as an expense, and a corresponding accrual for estimated losses on guaranteed loans is reported as a liability on the Consolidated Statement of Financial Position.

The adjustments in the accrual for estimated losses (also see Note 6) as of September 30, 1988 and 1987, in thousands of dollars, follow:

	Beginning Balance October 1, 1987	Loss Settlement	Adjustments to Accrual for Estimated Losses	Ending Balance September 30, 1988
ACIF	$ 644,338	$ (82,057)	$ 606,163	$1,168,444
RHIF	271	(404)	366	233
RDIF	119,822	(31,025)	21,113	109,910
TOTAL	$ 764,431	$ (113,486)	$ 627,642	$1,278,587

	Beginning Balance October 1, 1986	Loss Settlement	Adjustments to Accrual for Estimated Losses	Ending Balance September 30, 1987
ACIF	$ 38,814	$ (77,750)	$ 683,274	$ 644,338
RHIF	369	(166)	68	271
RDIF	132,526	(17,788)	5,084	119,822
TOTAL	$ 171,709	$ (95,704)	$ 688,426	$ 764,431

Invested Capital

Invested Capital represents: amounts appropriated by Congress to commence operations of the revolving funds; amounts appropriated to increase the working capital of revolving funds which do not receive reimbursement for losses (Note 2); donations or nonreciprocal transfer of assets from other agencies; the results of operations from the transferred assets; and the Government's net investment in FmHA's property and equipment.

The following is a summary of the activity in Invested Capital for the 1988 and 1987 fiscal years:

	Invested Capital 1988	1987
	(Dollars in Thousands)	
Beginning Balance	$ 1,142,489	$ 1,140,844
Fiscal Year Activity:		
Appropriated Increase to Working Capital	7,500	0
Capital Expenditures	3,505	3,068
Depreciation	(3,776)	(1,668)
Book Value of Disposed Equipment	(1,082)	(555)
Nonreciprocal Transfer of Loan Assets from Other Agencies	573	1,041
Loan Repayments Returned to U.S. Treasury	(385)	(452)
Results of Operations from the Transferred Loan Assets	(12)	211
Ending Balance	$ 1,148,812	$ 1,142,489

Cumulative Results of Operations

The Cumulative Results of Operations is the net result of operations from the revolving funds since their inception and the amounts reimbursed due to realized losses (Note 12). The following is a summary of the 1988 and 1987 fiscal years' activity for the Cumulative Results of Operations:

	Cumulative Results of Operations 1988	1987
	(Dollars in Thousands)	
Beginning Balance	$(36,335,417)	$(18,662,411)
Fiscal Year Activity:		
Net Results from Operations	(13,806,216)	(22,086,677)
Reimbursement for Losses	7,554,171	4,413,671
Ending Balance	$(42,587,462)	$(36,335,417)

NOTE 13: LOAN ASSET SALES

As in the previous fiscal year, FmHA was required to sell loan assets in fiscal year 1988. An overview of the 1988 and 1987 sales (required by the Agricultural Credit Act of 1987 and the Omnibus Budget Reconciliation Act of 1986, respectively) follows:

	1988	1987
	(Dollars in Thousands)	
Receivables Sold:	$1,663,735	$5,006,885
Proceeds:		
Cash	1,086,842	2,871,673
Investments in Loan Sale Trust Assets (Note 7)	0	234,615
Protective Advance Fund	0	10,000
Total Proceeds	$1,086,842	$3,116,288
Loss on Sale of Loans:	$ 576,893 *	$1,890,597

* NOTE: The $576,893,000 loss shown above relates solely to those loan assets actually sold in fiscal year 1988. FmHA also provided for in fiscal year 1988 an estimated $498,000,000 loss attributable to the anticipated loan asset sale of fiscal year 1989. Consequently, the total loss on sale of loans recognized in fiscal year 1988 was $1,074,893,000. Information regarding the 1989 loan asset sale is furnished within this note under Future Asset Sales.

An allowance for losses amount was not allocated to the 1988 or 1987 receivables sold due to immateriality.

1987 Loan Asset Sales

The asset sales of fiscal year 1987 were primarily conducted through the sale of a portion of FmHA's rural housing and community programs loan portfolio to the Rural Housing Trust, 1987-1, and the Community Program Loan Trust, 1987A, respectively. Additionally, prior to the sale of community program loans to the Trust, eligible community program borrowers were given the opportunity to purchase their loans at a discount.

The asset sale conducted with the Rural Housing Loan Trust, 1987-1, consisted of the sale of approximately $2.9 billion of rural housing loans. FmHA received over $1.7 billion and investments in the Trust and a protective advance fund valued at $211 million ($201 million and $10 million, respectively). A loss of approximately $1 billion was realized on the rural housing loan sale.

The asset sale conducted with the Community Program Loan Trust, 1987A, consisted of the sale of $1.9 billion of community program loans. The sale proceeds were approximately $1.1 billion and an investment in the Trust valued at $33.6 million. FmHA realized a loss of approximately $842 million on the community program loans sold to the Trust.

In addition to the community program trust sale, $52.7 million was received from the sale of $72.1 million of receivables directly to borrowers. Borrowers who purchased their loans received a discount of $19.5 million.

NOTE 14: CONSOLIDATED SCHEDULE OF BUDGET RECONCILIATION

The following schedule provides a reconciliation of expenses to budgetary outlays as of September 30, 1988 and 1987:

	1988	1987
	(Dollars in Thousands)	
Expenses As Reported on Consolidated Statement of Operations:		
Nonperforming Loans Interest	$ 997,267	$ 1,093,355
Total Interest Expense	8,987,288	9,337,861
Total Provision for Losses	6,008,583	13,674,463
Total Other Expenses	3,494,316	4,279,405
Total Expenses	19,487,454	28,385,084
Deduct:		
Expenses Not Requiring Outlays:		
Provision for Losses on:		
Loans (Note 6)	5,090,231	9,315,840
Accrued Interest on Loans (Note 6)	85,318	3,063,104
Guaranteed Loans (Note 10)	627,642	688,426
Acquired Property (Note 8)	205,392	607,093
Loss on Sale of Loan Assets (Note 13)	1,074,893	1,890,597
Interest Credit Program Expense (Note 4)	1,427,314	1,514,131
Interest on Nonperforming Loans (Note 6)	997,267	1,093,355
Other	27,004	50,675
Total Expenses Not Requiring Outlays	9,535,061	18,223,221
Expenses Requiring Outlays	9,952,393	10,161,863
Add:		
Other Outlays:		
Loans Made	3,493,511	3,874,236
Loss Settlement of Guaranteed Loans	113,486	95,704
Acquired Property Disbursements	73,698	91,195
Purchase of Loans	262,015	59,123
Payments Made to Investors	74,550	51,884
Payments on Notes Payable	371,947	35,179
Other	6,854	1,394
Total Other Outlays	4,396,061	4,208,715
Change in Accounts and Accrued Interest Payables	227,540	7,990
Total Outlays	14,575,994	14,378,568
Less Offsetting Collections	7,301,875	10,633,419
Net Outlays	$ 7,274,119	$ 3,745,149

Within RHIF, the portfolio is comprised of single family housing (SFH) and multiple family housing (MFH) loans. Regarding the SFH loan programs, the stated rate on the majority of loans approximates the U.S. Treasury average interest rate. Although SFH borrowers may participate in the interest credit program (thereby receiving an effective rate below the market rate), the interest credit is subject to an annual review/adjustment. Additionally, FmHA is authorized to recapture partial or full repayment of the interest credit when the property is sold, transferred, or vacated by the borrower and appreciation in the property has occurred. Because an unknown portion of the interest credit may be recovered and the fact that few SFH loans are held to the full term of the note, the extent of the interest rate cost subsidy over the life of SFH loans cannot be reasonably estimated. The stated interest rate on MFH loans also approximates the average Treasury rate; however, MFH loans are eligible for interest credit for the entire life of the loan and is not subject to recapture. FmHA estimates the unamortized discount on MFH loans would approximate $5.2 billion as of September 30, 1988. The expense of providing the interest credit program to SFH and MFH borrowers is currently recognized as an operating expense during the year and reported in the Consolidated Statement of Operations. (See Note 4 for additional information regarding the RHIF interest credit program expense.)

These estimates assume borrower repayments under the terms of the note. Also, if the $9.6 billion unamortized loan discount was reported on the Statement of Financial Position, then the related allowance for losses would be established based on the discounted loans receivable. It is estimated that the allowance for losses would be reduced by approximately $6.8 billion and the net cumulative effect of reporting the unamortized discount would cause an approximate $2.8 billion reduction in net loans receivable.

Since unamortized discount and allowance for loss data are not maintained on a loan-by-loan basis, the reduction in the allowance for losses was based upon an analysis of each of the largest funds in aggregate. A loan-by-loan analysis would be required to determine the actual effect of the unamortized discount on the allowance for losses computation.

Following are the estimated adjustments which would be necessary to recognize the interest rate cost subsidy on the below market rate loans receivable as of September 30, 1988. These estimated adjustments represent the cumulative effect on all prior years and the current year.

Consolidated Statement of Financial Position

	(Dollars in Thousands)
ASSETS:	
Loans Receivable, as presently recorded, net of allowance for losses	$39,697,111
Cumulative effect on current and prior years of recording interest rate cost subsidy	(9,646,835)
Cumulative effect on current and prior years of recording interest rate cost subsidy on allowance for losses	6,784,102
Loans Receivable, net	$36,834,378
EQUITY:	
Cumulative Results of Operations, as presently recorded	$(42,587,462)
Cumulative effect on current and prior years of recording interest rate cost subsidy	(2,862,733)
Cumulative Results of Operations	$(45,450,195)

Consolidated Statement of Operations

Net Loss from Operations, as presently recorded	$(13,806,228)
Cumulative effect on current and prior years of recording interest rate cost subsidy	(2,862,733)
Net Loss from Operations	$(16,668,961)

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NOTE 15: RECONCILIATION OF NET LOSS TO NET CASH USED IN OPERATING ACTIVITIES

The following schedule provides a reconciliation of net loss to the net cash used in operating activities as reported on the Consolidated Statement of Cash Flows for the fiscal years ended September 30, 1988 and 1987:

	1988	1987
	(Dollars in Thousands)	
Net Loss from Operations	$(13,806,228)	$(22,087,659)
Adjustments:		
Expenses Not Requiring Outlays (Note 14)	9,535,061	18,223,221
Income Attributable to Interest Credit Program	(1,427,314)	(1,514,131)
Appropriations Received	574,098	556,806
Expended Appropriations	(589,225)	(601,588)
Interest Receivable Reclassified	(255,770)	(449,043)
Change in Interest Receivable	(329,058)	(439,070)
Interest Receivable Written-Off, Net	(491,323)	(263,687)
Change in Accounts Receivable	95,261	(27,870)
Change in Accounts and Accrued Interest Payables	(227,540)	(7,990)
Other	(30,113)	47,047
Total Adjustments	6,854,077	15,523,695
Net Cash Used in Operating Activities	$(6,952,151)	$(6,563,964)

NOTE 16: INTEREST RATE COST SUBSIDY

FmHA loan making activities provide for stated loan interest rates which are below Treasury market rates. Because the revolving funds typically borrow money to fund these lending programs at the U.S. Treasury rate, costs associated with making loans at a lower interest rate have historically been recognized through the difference between the interest expense on intragovernmental debt and accrued loan interest income on an annual basis.

Federal accounting principles governing the recording of interest rate cost subsidy on below market rate receivables are undergoing reexamination by the Congress, the Executive Branch, and the General Accounting Office. The final interpretation of federal accounting principles, as they relate to interest rate cost subsidy, cannot presently be determined. Accordingly, the FmHA accounting system currently does not provide for loan discounting or provide the automated capability for the related accounting entries over the life of the loan.

Within ACIF, loans are available at limited resource rates significantly below the Treasury average interest rate. Based on an analysis of loans outstanding as of September 30, 1988, if a discount had been recognized at the time of loan closing, the unamortized discount would approximate $2.8 billion. Similarly, within RDIF, community facility and water and waste loans are typically made at interest rates substantially below the U.S. Treasury average interest rate. In analyzing RDIF loans outstanding as of September 30, 1988, if a discount had been recognized at the time of loan closing, the unamortized discount would approximate $1.6 billion.

1988 Loan Asset Sales

During fiscal year 1988, FmHA sold only community program loan assets through a borrower buyback offer (Discount Purchase Program) whereby eligible borrowers were provided the opportunity to purchase their loans at a discount under the provisions of the Agricultural Credit Act of 1987. The Act extended to eligible community program borrowers the right to buy back their loans at a price comparable to that paid by the Community Program Loan Trust, 1987A (the community program trust asset sale of fiscal year 1987), but updated for current market conditions.

During fiscal year 1988, approximately 2100 borrowers purchased nearly 3700 loans with an unpaid balance, including accrued interest, of $1,663,734,368. Proceeds from the Discount Purchase Program amounted to $1,086,841,795. The discount associated with the program was $576,892,573.

Future Asset Sales

Farmers Home Administration is required by the Omnibus Budget Reconciliation Act of 1986 and the Continuing Appropriations Act of 1987 to raise net proceeds of $584 million in fiscal year 1989 through the sale of community program loans. The Rural Development, Agriculture, and Related Agencies Appropriations Act of 1989 includes a provision which requires that before any loans are sold borrowers be afforded the opportunity of prepayment. Based on these statutory requirements, FmHA plans to offer another Discount Purchase Program to eligible community program borrowers. To the extent proceeds from this program do not meet the required $584 million, FmHA will conduct a sale of loans (securitized sale, private placement, or some other type of third party sale) which will achieve the full amount.

As of March 1989 approximately 1800 borrowers with unpaid principal balances of $1.679 billion have indicated interest in the Discount Purchase Program. Interested community program borrowers have until May 9, 1989, to submit their final payment; however, it is anticipated that not all borrowers will comply. Consequently, FmHA has estimated that sufficient payments will be received to satisfy loan balances with an approximate face value in the range of $1.458 to $1.679 billion resulting in a loss of approximately $498 to $574 million. Accordingly, the fiscal year 1988 consolidated financial statements provide for an estimated $498 million loss (included in the loss on sale of loan assets on the Consolidated Statement of Operations) through an increase in the allowance for loan losses on the Consolidated Statement of Financial Position.

NOTE 12: CUMULATIVE RESULTS OF OPERATIONS

Cumulative results of operations represent the cumulative deficit or surplus resulting from operations for all of the FmHA revolving funds. The cumulative results of operations for the Agricultural Credit Insurance Fund (ACIF) which was established in 1946, the Rural Housing Insurance Fund (RHIF) which was established in 1965, and the Rural Development Insurance Fund (RDIF) which was established in 1972 equal the net losses sustained from current and all prior years less the accumulated reimbursements for realized losses received by those funds. The cumulative results of operations, by entity, as of September 30, 1988, follow:

	Net Losses (Inception)	Reimbursement for Losses (Inception)	Cumulative Results of Operations
ACIF	$(39,546,722,703)	$10,980,735,000	$(28,565,987,703)
RHIF	(25,012,183,840)	15,128,687,573	(9,883,496,267)
RDIF	(8,245,456,735)	4,110,668,000	(4,134,788,735)
All Others	(3,189,600)	0	(3,189,600)
Total	$(72,807,552,878)	$30,220,090,573	$(42,587,462,305)

The reimbursement for realized losses does not include current and prior fiscal year realized losses eligible for future reimbursement. Additionally, FmHA was not fully reimbursed for the losses sustained in fiscal year 1986, which will be carried forward and requested in the next fiscal year. The potential reimbursements (based on the fiscal year of loss realization) which FmHA may receive pursuant to Congressional action follow:

	1986	1987	1988	Total
ACIF	$ 35,000,000	$3,442,596,000	$4,452,159,000	$ 7,929,755,000
RHIF	0	3,660,061,000	2,677,897,000	6,337,958,000
RDIF	7,500,000	1,592,047,000	1,470,999,000	3,070,546,000
Total	$ 42,500,000	$8,694,704,000	$8,601,055,000	$17,338,259,000

Reported cumulative results of operations in excess of the outstanding requests for reimbursement primarily represent allowance for future losses on receivables, allowance for losses on acquired property, and accrual for estimated losses on guaranteed loans.

NOTE 11: EQUITY

Unexpended Appropriations

Unexpended Appropriations include the undelivered orders and unobligated balances of the FmHA general funds which receive Congressional appropriations through the budgetary process.

As appropriated funds incur obligations, the obligated amount is recorded as an undelivered order and shown as an equity item on the Consolidated Statement of Financial Position. Undelivered orders are relieved by either an expenditure or an obligation cancellation. Appropriated funds which are not obligated are shown as the unobligated amount of the Unexpended Appropriations on the Consolidated Statement of Financial Position. At the end of the fiscal year, certain multi-year appropriations which have unobligated balances remain available to FmHA for obligation in future periods. Unobligated appropriations returned to the U.S. Treasury may be made available for restoration to FmHA subject to administrative determination.

The following summarizes the activity for the appropriations and the Unexpended Appropriations balances of the appropriated funds for the 1988 and 1987 fiscal years in thousands of dollars:

	Appropriations	Undelivered Orders	Unobligated Balances
Beginning Balances, October 1, 1987		$525,036	$ 11,839
Fiscal Year Activity:			
Appropriations Received	$574,098		574,098
Obligations Incurred		577,653	(577,653)
Obligations Cancelled		(14,570)	14,570
Accrued Expenditures		(592,730)	
Reimbursements		(1,473)	1,473
Balances Returned to U.S. Treasury			(12,710)
Ending Balances, September 30, 1988	$574,098	$493,916	$ 11,617

	Appropriations	Undelivered Orders	Unobligated Balances
Beginning Balances, October 1, 1986		$583,473	$ 8,684
Fiscal Year Activity:			
Appropriations Received	$556,806		556,806
Obligations Incurred		562,256	(562,256)
Obligations Cancelled		(16,037)	16,037
Accrued Expenditures		(602,890)	
Reimbursements		(1,766)	1,766
Balances Returned to U.S. Treasury			(9,198)
Ending Balances, September 30, 1987	$556,806	$525,036	$ 11,839

Supplemental information associated with fiscal years 1988 and 1987 long-term borrowings follows:

Accrued Interest Payable
(Dollars in Thousands)

	1988	1987
Intragovernmental Debt:		
U.S. Treasury	$ 706,981	$ 651,537
Federal Financing Bank	2,829,543	3,081,562
Subtotal	3,536,524	3,733,099
Private Investors	37,783	56,320
Other	6,552	31,472
TOTAL	$ 3,580,859	$ 3,820,891

Interest Expense
(Dollars in Thousands)

	1988	1987
Intragovernmental Debt:		
U.S. Treasury	$ 1,211,362	$ 1,155,462
Federal Financing Bank	7,678,991	8,046,262
Subtotal	8,890,353	9,201,724
Private Investors	68,851	84,762
Other	28,084	51,375
TOTAL	$ 8,987,288	$ 9,337,861

During July 1974, FmHA began selling Certificates of Beneficial Ownership (CBO) to the Federal Financing Bank (FFB) as a primary means of program financing. The CBO interest rate is based on Treasury's cost of money plus 1/8 of 1 percent to cover FFB's administrative expenses. The interest rates on FFB CBO's outstanding as of September 30, 1988, range from 7.324 percent to 16.516 percent.

During fiscal year 1988, FmHA was required to pay a prepayment penalty on the early retirement of FFB CBO's. In complying with the mandated loan asset sales, FmHA diminished the unpaid loan principal balances which served as collateral for the CBO's. The agreement between FmHA and FFB provides that redemption of CBO's may occur at any time; however, the payment made shall be of an amount "which will result in a yield for the period from the date of repurchase to the maturity date of such CBO equal to the U.S. Treasury new issue rate for a security with a maturity and payment schedule comparable to the remaining maturity and payment schedule of such CBO." The application of this provision of the agreement resulted in a penalty of $79,507,592.

NOTE 7: INVESTMENTS IN LOAN SALE TRUST ASSETS

In fiscal year 1987, FmHA conducted loan asset sales as required in the Omnibus Budget Reconciliation Act of 1986 (Public Law 99-509). As a result of these sales (Note 13), the Rural Development Insurance Fund (RDIF) maintains an investment in the Community Program Loan Trust, 1987A. This investment, reported at its appraised value of $33,614,488, represents a Class C residual security in the Trust and entitles the holder to residual cash flows resulting from loan repayments not required to pay trust security holders or to fund required reserves.

The Rural Housing Insurance Fund (RHIF) maintains an investment in the Rural Housing Trust, 1987-1. This investment represents Class B securities valued at $178,660,537 (1987 appraised value of $180,000,000 less return of investment received during fiscal year 1988 of $1,339,463) and Class C residual securities valued at $21,000,000.

FmHA intends to retain the RDIF and RHIF Class C investments at least until a sufficient track record has been established to allow their true value to be determined. FmHA intends to sell the RHIF Class B investment during fiscal year 1990. Based on estimates of the Class B investment's future value, it is anticipated that FmHA will receive sale proceeds not less than its recorded value.

NOTE 8: ACQUIRED PROPERTY

Acquired property is reported at net realizable value (estimated market value less cost of disposition). Property is acquired by the FmHA revolving funds largely through foreclosure and voluntary conveyance. The properties consist primarily of 4,685 farm properties (total acreage of approximately 1.5 million) and 12,330 rural single family dwellings which are held by the revolving funds for resale. The revolving funds are allowed to lease certain properties to eligible individuals for a period not to exceed 1 year. Fiscal years 1988 and 1987 lease and rental income of $10,769,632 and $11,566,253, respectively, is reported as other income on the Consolidated Statement of Operations.

The 1987 Agricultural Credit Act provides borrower rights regarding the sale of acquired farm properties. In order to protect these rights, restrictions were imposed on the sale of acquired farm properties.

During GAO's FY 1987 financial audit, internal control weaknesses were cited concerning the valuation of acquired property and the reconciliation of the property accounting records. Due to accounting system limitations in recording gains or losses realized at the time property is acquired through voluntary conveyance, FmHA implemented procedures in fiscal year 1988 to properly report these losses as loan losses. These procedures estimated the losses incurred from property acquired through voluntary conveyance and included these losses in the loan receivable writeoffs. These weaknesses will continue to exist and related corrective procedures will remain in effect until revisions are fully implemented to the acquired property system. These revisions are included in a major systems alteration currently in process.

NOTE 6: ALLOWANCE FOR LOSSES

In fiscal year 1988 FmHA substantially completed the implementation of a loan classification system; approximately 75 percent of the portfolio including farmer and single family housing program loans was classified. The loan classification system, required by OMB Circular A-129, provides the Agency additional data to assist in assessing the credit risk of the portfolio. OMB Circular A-129 provides that Federal agencies annually perform a risk assessment of their portfolio and assign risk ratings. The risk ratings are based on the borrower's financial position, payment history, collateral or security value, as well as other relevant information.

An analysis of the comparability of the fiscal years 1988 and 1987 provision for losses must include recognition that the 1987 provision provided for both the current provision as well as adjustments to prior year provisions. The significant increase in the fiscal year 1987 allowance for losses was related to the declining trend in the agricultural economy over several years; that is, the increase was not attributable to a single adverse event during fiscal year 1987.

The procedures followed in estimating losses for fiscal year 1988 included:

--The allowance for loan losses is based on historical data (consisting of writeoffs, loan settlement data, and acquired property losses), and an analysis of the loan classification of borrower accounts, and an analysis of current market factors and conditions (to include delinquent, rescheduled, and collection-only accounts).

--The allowance for losses on accrued interest receivable is based on historical data (cumulative writeoffs of interest receivable), an analysis of the loan classification of borrower accounts, and an analysis of recent delinquency data. The latter analysis provides for a 100 percent allowance for loss on the interest receivable on loans delinquent over 90 days.

The other adjustments in allowance for loan losses for 1988 include an estimated $498 million loss on the anticipated fiscal year 1989 sale of community program loan assets. The $498 million estimated loss is not reported in the Provision for Losses on Loans but is included in the Loss on Sale of Loan Assets in the Consolidated Statement of Operations (Note 13).

The other adjustments in allowance for interest losses represent Interest on Nonperforming Loans as reported in the Consolidated Statement of Operations.

The provision and other adjustments in the allowance for losses for the fiscal years 1988 and 1987 follow:

	Allowance for Loan Losses		Allowance for Interest Losses	
	1988	1987	1988	1987
	(Dollars in Thousands)		(Dollars in Thousands)	
Beginning Balance	$ 14,664,348	$ 6,102,903	$ 4,279,752	$ 386,980
Receivables Written Off, Net	(1,779,078)	(754,395)	(491,323)	(263,687)
Provision for Losses	5,090,231	9,315,840	85,318	3,063,104
Other Adjustments in Allowance for Losses	498,000	0	997,267	1,093,355
Ending Balance	$ 18,473,501	$ 14,664,348	$ 4,871,014	$ 4,279,752

NOTE 5: LOANS

The unpaid principal balances and the related allowance for losses by entity and major loan program as of September 30, 1988 and 1987, follow:

	September 30, 1988 (Dollars in Thousands)			September 30, 1987 (Dollars in Thousands)		
	Unpaid Principal	Allowance for Losses on Principal (Note 6)	Net Unpaid Principal	Unpaid Principal	Allowance for Losses on Principal (Note 6)	Net Unpaid Principal
Agricultural Credit Insurance Fund						
Farm Ownership	$ 7,304,333	$ 2,629,309	$ 4,675,024	$ 7,549,307	$ 1,978,908	$ 5,570,399
Operating	5,729,855	2,409,106	3,320,749	6,280,074	2,085,088	4,194,986
Emergency	8,419,073	6,585,509	1,833,564	9,292,036	5,751,240	3,540,796
Economic Emergency	3,419,262	2,842,750	576,512	3,798,945	2,331,236	1,467,709
Other	564,036	28,095	535,941	587,966	15,360	572,606
Guaranteed loans purchased from holders	29,742	14,871	14,871	28,733	14,367	14,366
	25,466,301	14,509,640	10,956,661	27,537,061	12,176,199	15,360,862
Rural Housing Insurance Fund						
Rural Housing	18,560,191	3,118,259	15,441,932	18,368,197	2,126,932	16,241,265
Labor Housing	137,566	19,667	117,899	139,457	19,937	119,520
Rural Rental Housing	8,347,437	64,300	8,283,137	7,901,688	60,867	7,840,821
Rural Housing Site	566	1	565	704	1	703
Guaranteed loans purchased from holders	1,641	821	820	1,258	629	629
	27,047,401	3,203,048	23,844,353	26,411,304	2,208,366	24,202,938
Rural Development Insurance Fund						
Water & Waste	4,072,137	465,434	3,606,703	5,192,352	28,320	5,164,032
Community Facilities	1,025,371	47,310	978,061	1,183,506	683	1,182,823
Business & Industrial	36,914	862	36,052	37,689	880	36,809
Guaranteed loans purchased from holders	484,997	242,499	242,498	492,127	246,064	246,063
	5,619,419	756,105	4,863,314	6,905,674	275,947	6,629,727
All Other Entities	37,491	4,708	32,783	38,495	3,836	34,659
Total FmHA	$58,170,612	$18,473,501	$39,697,111	$60,892,534	$14,664,348	$46,228,186

FmHA had unliquidated loan and grant obligations of $4,845,631,423 and $4,962,626,952 as of September 30, 1988 and 1987, respectively.

Expended Appropriations

Appropriations are provided by Congress on both an annual and multi-year basis to fund certain general funds and other expenses such as personnel compensation and fringe benefits, rents, communications, utilities, other administrative expenses, and capital expenditures. The current budgetary process does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of budgetary resources as paid, however for financial reporting purposes under accrual accounting, operating expenses are recognized currently while expenditures for capital and other long-term assets are capitalized and are not recognized as expenses until they are consumed in FmHA's operations. Appropriations for general fund activities are recorded as a financing source when expended. Unexpended appropriations are recorded as equity of the U.S. Government (Note 11).

Loss Reimbursement

Reimbursement for losses is provided by Congressional appropriations and is used to reimburse the three major revolving funds of FmHA for losses sustained in excess of reported income. The losses reimbursed include actual amounts written off and losses sustained on the sale of acquired property; however, adjustments in the allowance accounts to record estimated future losses are not included in the requests for reimbursement. Requests for reimbursement are submitted as part of the budgetary process. Appropriations to reimburse revolving fund losses are typically received 2 years after the year in which the loss was sustained (Notes 11 and 12) and are recorded as an offset to cumulative results of operations.

Intragovernmental Financial Activities

The FmHA's consolidated financial statements are not intended to report the Agency's proportionate share of the Federal deficit or of public borrowings, including interest thereon. Financing for budget appropriations reported on the FmHA's Consolidated Statement of Operations and Consolidated Statement of Cash Flows could derive from tax revenues or public borrowings or both; the ultimate source of this financing, whether from tax revenues or public borrowings, has not been specifically allocated to the FmHA.

During fiscal years 1988 and 1987, the majority of the FmHA's employees participated in the contributory Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS), to which FmHA made matching contributions. The FmHA does not, however, report CSRS and FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees since this data is only reported in total by the Office of Personnel Management.

NOTE 3: ACCOUNTS RECEIVABLE

Accounts receivable is comprised primarily of receivables resulting from accrued rent on acquired property, accrued interest on judgments, and the recapture of interest credit. Of these, the most significant is the $18,987,773 recapture of interest credit receivable. This amount represents the amount of interest credit to be repaid to the Government and is determined after giving consideration to the amount of interest credit provided, the appreciation in property value, the method used to satisfy the loan, the period of time the loan was outstanding, and the amount of equity the borrower has in the property when the loan is satisfied.

The substantial reduction in the amount of accounts receivable during fiscal year 1988 is primarily attributable to the collection of the Government National Mortgage Association (GNMA) receivable. This receivable ($104,835,716 as of September 30, 1987) became due and payable to FmHA in fiscal year 1988 due to the maturity of the outstanding GNMA participation certificates.

Guaranteed Lending Activities

In addition to the insured lending activities, FmHA has authority to guarantee loans. The term "guarantee" means "to guarantee the payment of a loss on a loan originated, held, and serviced by a private financial agency or other lender approved by the Secretary of Agriculture." FmHA provides financial assistance to borrowers by guaranteeing loans made by a federal or state chartered bank, savings and loan association, cooperative lending agency, or approved lending institution who perform all loan servicing activities. Guaranteed loans are accounted for as contingent liabilities (Note 10).

The guaranteed loan program allows FmHA to guarantee up to 90 percent of the money loaned by a financial institution (lender) to borrowers in rural areas or who employs people in rural areas.

The lender is required to inform FmHA on the loan status on December 31 and June 30 (depending on the type of loan), unless the loan is in default which requires more frequent reporting.

Most guaranteed loans may be sold in the secondary market by the lender to an institution known as a holder. Although a portion of the loan is sold to a holder, all servicing responsibility remains with the lender. Payments by the borrower are forwarded on a pro rata basis to the holder. If the holder does not receive payments on the note within 60 days of an installment due date, the holder can demand that FmHA purchase the holder's share of the loan. When the loan is purchased, FmHA assumes the rights of the holder and is entitled to the pro rata share of any payments made by the borrower to the lender. All guaranteed loans purchased by FmHA are treated as an asset (loans receivable) in its portfolio (Note 5).

If the borrower defaults on the loan, the lender is responsible for liquidating the collateral. After the proceeds of the sale have been applied to the outstanding balances, FmHA is liable for losses under the terms of the guarantee (Notes 5, 6, and 10).

Interest Rate Buydown Program:
The Food Security Act of 1985 (Public Law 99-198) authorized FmHA to enter into an agreement with participating guaranteed lenders to reduce the interest rate paid by guaranteed borrowers. In return, FmHA will make annual interest rate buydown payments to the lender in an amount not to exceed 50 percent of the cost of reducing the interest rate on the loan up to a maximum of two percentage points. The Act authorized $490,000,000 for this program to be available through September 30, 1988. As of September 30, 1988, funds were obligated for this program in the amount of $48,930,066.

Agricultural Credit Act of 1987

With the passage of the Agricultural Credit Act of 1987 (Public Law 100-233), the loan servicing options of delinquent farmer program borrowers were expanded. The regulation changes FmHA has made to accommodate the Act became effective October 14, 1988. In addition to the servicing options that were available prior to the Act, FmHA anticipates the following two new options will have a significant impact on the farmer program loans receivable. As of September 30, 1989, FmHA notified 75,352 delinquent borrowers of all the servicing options available.

Debt Write-Down Program

The Act permits FmHA to write-down farmer program loans to the recovery value of the collateral if the borrower has a feasible plan to continue the farming operation. Loans can be written-down only if the restructured loan would result in recovery to the Government that would be equal to or greater than the amount recovered if the collateral was involuntarily liquidated. Borrowers who participate in the Debt Write-Down Program must sign a shared appreciation agreement entitling FmHA to share in the appreciation of the real estate securing the loan, thereby recapturing a portion of the debt write-down amount. The agreement allows FmHA to receive from 50 to 75 percent of the appreciation during the life of the 10-year agreement if, during the 10 years, the borrower sells or conveys the property, ceases farming operations, or pays the debt in full. At the end of the tenth year, the borrower must pay 50 percent of the appreciation on the property. The amount

Notes to Financial Statements

FOR FISCAL YEARS ENDED SEPTEMBER 30, 1988 AND 1987

NOTE 1: ORGANIZATION AND PROGRAMS

Entity and Basis of Consolidation

Farmers Home Administration (FmHA) is the credit agency for agriculture and rural development in the U.S. Department of Agriculture (USDA). In 1988, the Agency marked 53 years of financial and technical assistance to rural America. This service has been performed under the successive names of Resettlement Administration, Farm Security Administration, and Farmers Home Administration.

When it began in 1935, the Agency's original function was to make loans and grants to Depression-stricken families and help them regain self-sufficiency in making their living on family farms. For 53 years, FmHA has been concerned primarily with credit and counseling services that have supplemented resources of the private sector for building strong family farms. In 1988, farm credit still accounted for almost one-half of all resources administered by FmHA. This fact was particularly apparent in 1988 when America's farmers were hit by the worst drought since the Depression era. FmHA responded with a full package of farm credit assistance including low interest emergency farm loans. The Agency designated 1,489 counties eligible for emergency loans. In its farm programs, FmHA made or guaranteed over 37,700 loans totalling $2.3 billion to farmers who could not otherwise obtain credit from commercial lenders.

During the last 2 decades, Congress created additional nonfarm programs to benefit families and communities in rural areas. These programs have helped to provide safe, modest housing; modern, sanitary water and sewer systems; essential community facilities; and job- and economy-boosting business and industry in rural areas. These are reflected in the current mission statement which directs FmHA to "serve as a temporary source of supervised credit and technical support for rural Americans for improving their farming enterprises, housing conditions, community facilities, and other business endeavors until they are able to qualify for private sector resources."

Over the years, FmHA has developed a credit system that reaches the county level. The Agency has approximately 11,400 permanent full-time employees who serve rural America from 46 State Offices, 266 District Offices, and 1,907 County Offices, plus the National Office in Washington, D.C., and the Finance Office in St. Louis, Missouri. Service is provided in every rural county or parish in the 50 states, plus the Pacific Trust Territory, American Samoa, Guam, Puerto Rico, and the Virgin Islands.

In fulfilling its mission as a "lender of last resort" in providing housing, credit, and agricultural assistance to people in rural areas, the Farmers Home Administration (FmHA) maintains 11 general funds, 5 revolving funds, and 2 other funds. The majority of FmHA loans are made from three revolving loan funds. The oldest is the Agricultural Credit Insurance Fund (ACIF), established when FmHA began to make insured loans in the 1940's, and now the fund from which all farmer program loans are made. The Rural Housing Insurance Fund (RHIF) was established with inauguration of insured rural housing loans in 1965. The Rural Development Insurance Fund (RDIF), established under the Rural Development Act of 1972, took over from ACIF the Agency's lending for water, sewer, and other community facilities, and for business and industrial development.

The consolidated financial statements account for all funds for which FmHA is responsible and are presented on the accrual basis of accounting as required by the GAO Policy and Procedures Manual for Guidance of Federal Agencies (Title 2).

Consolidated Statements of Operations

	For Fiscal Years Ended September 30 1988	1987
	(Dollars in Thousands)	
INTEREST INCOME:		
Interest on Loans (Note 4)	$ 3,578,579	$ 4,148,326
Less Interest on Nonperforming Loans (Note 6)	997,267	1,093,355
Interest Income	2,581,312	3,054,971
INTEREST EXPENSE:		
Interest on Intragovernmental Debt (Note 9)	8,890,353	9,201,724
Other Interest Expense (Note 9)	96,935	136,137
Interest Expense	8,987,288	9,337,861
NET INTEREST EXPENSE	(6,405,976)	(6,282,890)
PROVISION FOR LOSSES ON:		
Loans (Note 6)	5,090,231	9,315,840
Accrued Interest on Loans (Note 6)	85,318	3,063,104
Acquired Property (Note 8)	205,392	607,093
Guaranteed Loans (Note 10)	627,642	688,426
Total Provision for Losses	6,008,583	13,674,463
NET INTEREST EXPENSE AND PROVISION FOR LOSSES	(12,414,559)	(19,957,353)
OTHER INCOME:		
Income Attributable to Interest Credit Program (Note 4)	1,427,314	1,514,131
Expended Appropriations	589,225	601,588
Other Income	86,108	33,380
Total Other Income	2,102,647	2,149,099
OTHER EXPENSES:		
Loss on Sale of Loan Assets (Note 13)	1,074,893	1,890,597
Interest Credit Program Expense	1,427,314	1,514,131
Grants and Contributions	351,532	348,647
Personnel Compensation and Fringe Benefits	303,905	298,647
Rents, Communications, and Utilities	42,451	45,205
Other Administrative Expenses	51,650	49,942
Other Program Expenses	163,063	132,236
Prepayment Penalty on Intragovernmental Debt (Note 9)	79,508	0
Total Other Expenses	3,494,316	4,279,405
NET LOSS FROM OPERATIONS	$(13,806,228)	$(22,087,659)

The accompanying notes are an integral part of these financial statements.

Report on Compliance With Laws and Regulations

We have audited the consolidated financial statements of the Farmers Home Administration (FmHA) for the fiscal years ended September 30, 1988 and 1987, and have issued our opinion thereon. This report pertains only to our consideration of compliance with laws and regulations for the year ended September 30, 1988. Our report on compliance with laws and regulations for the year ended September 30, 1987, is presented in GAO/AFMD-89-20, dated December 20, 1988.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and regulations applicable to FmHA is the responsibility of FmHA's management. As part of obtaining reasonable assurance as to whether the consolidated financial statements were free of material misstatement, we performed tests of FmHA's compliance with the following provisions of laws and regulations:

- Anti-Deficiency Act (31 U.S.C. 1341-1519);
- Debt Collection Act of 1982 (31 U.S.C. 3711-3719) and related regulations;
- Prompt Payment Act (31 U.S.C. 3901-3906);
- Omnibus Budget Reconciliation Act of 1986 (P.L. 99-509); and
- other legislation and regulations concerning FmHA's farm, housing, and community and business loans and grants.

The results of our tests indicate that, with respect to the items tested, the FmHA complied, in all material respects, with the provisions referred to in the third paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the FmHA had not complied, in all material respects, with those provisions.

applied the same factor to the current value of acquired farm property and a 7-percent factor to housing property to estimate $154.9 million in holding and disposition costs when computing the net realizable value of acquired property.

Without a sound methodology for determining holding and disposition costs and other refinements, loan loss estimates and the acquired property balance may be inaccurate.

Conclusions

FmHA's newly implemented Acquired Property Tracking System has improved its ability to track and account for property acquired through foreclosure and voluntary conveyance. However, FmHA has not reconciled APTS data to detailed records and has not implemented software enhancements that would detect unreasonable property values.

Although FmHA's loan classification system, implemented in fiscal year 1988, is a major step toward meeting Title 2 and OMB requirements, field office instructions that provide guidance for estimating realistic collateral values and computing estimated losses are applied inconsistently. In addition, FmHA has not performed reconciliations between the loan classification system data and detailed files to detect errors and omissions from the system.

Accordingly, without reconciliations of system data to source documents, consistent application of instructions, and necessary software enhancements, significant errors in the acquired property and loan loss allowance accounts occur and are not promptly detected and corrected.

In addition, the development of a sound methodology for determining holding and disposition costs is necessary to ensure that the loan loss estimate and the acquired property balance are reasonable.

Recommendations

We recommend that the Secretary of Agriculture direct the Administrator of the Farmers Home Administration to:

- Ensure that all county offices receive APTS reports, require periodic reconciliations of APTS report information with the detailed acquired property files as of fiscal year-end, and develop appropriate internal controls to detect the recording of unreasonable dollar values for inventory properties.

Weaknesses in the New Farm Loan Classification System

In response to our fiscal year 1987 report on internal accounting controls, FmHA implemented a loan classification system for its Agricultural Credit Insurance Fund (farm loan portfolio) to comply with Title 2 and OMB requirements. This system is designed to classify loans according to the degree of risk and to estimate losses based on collateral shortfalls. All farm loans were classified by September 30, 1988, and the information was used by FmHA as the primary basis for determining the fiscal year 1988 allowance for loan losses for its $25 billion farm loan portfolio.

However, our audit tests revealed significant internal control weaknesses in the farm loan classification system, which caused it to be unreliable. We reviewed a statistical sample of 500 FmHA farm loan classifications and supporting documentation and found that loss estimates were inaccurate in 212 of the 500 cases. Specifically, in the 212 cases, we identified the following types of problems:

- current market values of collateral were not always used to determine estimated loan losses,
- numerous procedural errors were made in computing estimated losses, and
- detailed files at the field offices were not reconciled with the automated farm loan classification system detailed records, resulting in the omission of loans from the system.

Although generally accepted accounting principles (GAAP) require that allowances for loan losses be based on present market conditions and other factors, we found that in numerous cases FmHA supervisors were not establishing market values for collateral in order to project loan losses. Market value is defined as the monetary value that FmHA could reasonably expect to receive for the property in a current sale to a willing buyer other than a forced or liquidation sale. In 104 cases, supervisors used outdated appraisals or borrower financial statements to establish the value of the collateral, as illustrated in the following examples.

- In 1988, FmHA estimated a loan loss of $12.1 million based on a 1981 appraisal of loan collateral. However, an updated September 30, 1988, appraisal of the collateral value indicated the loss would likely be about $6.7 million.
- Using estimated collateral values as stated on a borrower's financial statement as of January 1987, a loan was considered fully supported by

opinion on FmHA's system of internal accounting controls taken as a whole.

In our fiscal year 1987 report on internal accounting controls, we disclosed four conditions which we believed adversely affected FmHA's ability to record, process, and report financial data. Specifically, we found that

- controls over the entry of guaranteed loans into the accounting system were inadequate;
- FmHA's Automated Multiple Family Housing Accounting System (AMAS) was implemented with numerous control weaknesses;
- acquired property was improperly valued, and detailed property files were not reconciled with general ledger control accounts, and
- FmHA's analysis of the ultimate collectibility of its loan portfolio for establishing an adequate allowance for loss was not in accordance with OMB Circular A-129.

The results of our fiscal year 1988 examination indicate that FmHA improved its internal control procedures for ensuring that all guaranteed loans are recorded in the Guaranteed Loan Accounting System. Accordingly, we no longer consider this to be a material internal control weakness. Furthermore, although FmHA recognized AMAS internal control weaknesses in its fiscal year 1989 FMFIA report, we are not reporting on those weaknesses because corrective actions have been substantially completed.

However, our study and evaluation disclosed three conditions that we believe result in the risk that errors and irregularities in amounts that would be material in relation to FmHA's financial statements may occur and not be promptly detected. These weaknesses concern FmHA's valuation of acquired property, implementation of its new farm loan classification system, and its methodology for computing holding and disposition costs.

Control Weaknesses in the New Acquired Property Accounting System

In response to the deficiencies reported in our fiscal year 1987 report on internal accounting controls, FmHA implemented the Acquired Property Tracking System (APTS), an automated subsidiary accounting system for farm and housing properties acquired through foreclosure and voluntary conveyance. While APTS has improved FmHA's ability to track and account for acquired property, the system does not conform with GAO's Policy and Procedures Manual for Guidance of Federal Agencies, Title 2.

Report on Internal Accounting Controls

We have examined the consolidated financial statements of the Farmers Home Administration (FmHA) for the fiscal years ended September 30, 1988 and 1987, and have issued our opinion thereon. As part of our examination, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards. This report pertains only to our study and evaluation of the system of internal accounting controls for the fiscal year ended September 30, 1988. Our report on the study and evaluation of internal accounting controls for the year ended September 30, 1987, is presented in GAO/AFMD-89-20, dated December 20, 1988.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on FmHA's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting controls taken as a whole. For the purpose of this report, we have classified the significant internal accounting controls into the following categories:

- loans and grants,
- guaranteed loans,
- acquired property,
- treasury, and
- financial reporting.

Our study and evaluation included all of the control categories listed above, except for the treasury and financial reporting categories. For those categories, we found it more efficient to expand the scope of our substantive audit tests. Substantive audit tests can also serve to identify weaknesses in internal control policies and procedures.

The management of FmHA is responsible for establishing and maintaining a system of internal controls, including accounting controls, in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982 (FMFIA). In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures agricultural bank failures. In addition, bankruptcy filings by family farmers declined between the end of 1987 and the end of 1988.

However, the improved farm economy has not had the same positive impact on FmHA. FmHA, as the lender of last resort, has served as a "shock absorber" for the farm industry, providing financing to those farmers unable to qualify for loans with commercial lenders. As farmers' financial condition deteriorated significantly from the mid-1970s to the mid-1980s, increasing numbers of farmers who had been refused financing by private lenders, turned to FmHA for credit assistance. FmHA's farm loan portfolio increased from $5.1 billion in 1976 to $25.5 billion in 1988. As farmers' financial condition further deteriorated during this period, many ceased repaying their debts to FmHA. This severely affected FmHA's financial condition by increasing its loan losses and interest costs.

FmHA's farm loan portfolio remained stressed in 1988. FmHA increased its allowance for loan losses by $5.1 billion in fiscal year 1988. In addition, FmHA recognized a $628 million provision for losses related to its guarantee programs, increasing the accrual for estimated losses on guaranteed loans to $1.3 billion.

As of September 30, 1988, the outstanding principal balance on delinquent loans to farm program borrowers was about $12.5 billion or 49 percent of the total outstanding principal. As discussed in note 1 to the financial statements, the options of delinquent farm program borrowers were expanded with the passage of the Agricultural Credit Act of 1987. As of September 30, 1989, FmHA notified 75,352 delinquent borrowers of all servicing options available. With the use of these options, delinquent balances are expected to decrease.

The agricultural economy is driven by elements such as weather conditions, interest rate fluctuations, government agricultural and economic policies, and foreign economic conditions. These factors influence farm income and available cash, as well as the value of farm assets. Farmers' ability to repay debt and the value of the underlying collateral determine the ultimate realized losses on FmHA's loan portfolio. As discussed

GAO

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

Accounting and Financial Management Division

B-226249

To the Acting Administrator
Farmers Home Administration

We have audited the accompanying consolidated statements of financial position of the Farmers Home Administration (FmHA), an agency of the Department of Agriculture, as of September 30, 1988 and 1987, and the related statements of operations and cash flows for the fiscal years then ended. These financial statements are the responsibility of FmHA's management. Our responsibility is to express an opinion on these financial statements based on our audits. In addition to this report on our audits of FmHA's fiscal year 1988 and 1987 financial statements, we are also reporting on our consideration of FmHA's system of internal accounting controls and on its compliance with laws and regulations.

We conducted our audit in accordance with generally accepted government auditing standards, except for scope limitations as discussed in the following paragraphs. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Prior to fiscal year 1987, FmHA did not prepare its financial reports or maintain its accounting records in accordance with generally accepted accounting principles. Although FmHA adopted such principles during fiscal year 1987, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the results of operations and cash flows for the fiscal year ended September 30, 1987.

Our opinion on FmHA's fiscal year 1987 statement of financial position (GAO/AFMD-89-20) was qualified because FmHA's accounting system did not capture current property market values at the time of acquisition for voluntarily conveyed property, and it was not feasible for us to determine the amount of adjustments, if any, to the allowance for losses and the related provision that would have been required to record these assets at their fair values at the time of acquisition.

Our audit of the fiscal year 1988 financial statements disclosed that although FmHA implemented a new acquired property system (referred to as the Acquired Property Tracking System) during fiscal year 1988,

Contents

Abbreviations

AMAS	Automated Multiple Family Housing Accounting System
APTS	Acquired Property Tracking System
FMFIA	Federal Managers' Financial Integrity Act
FmHA	Farmers Home Administration
GAAP	generally accepted accounting principles
OMB	Office of Management and Budget

and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, the Acting Administrator of the Farmers Home Administration, and interested congressional committees.

Sincerely yours,

Donald H. Chapin
Assistant Comptroller General