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

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FOR RELEASE ON DELIVERY
EXPECTED BY 10:00am EST
THURSDAY, NOVEMBER 20, 1980

STATEMENT OF

DONALD L. SCANTLEBURY
DIVISION DIRECTOR AND CHIEF ACCOUNTANT OF GAO
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION

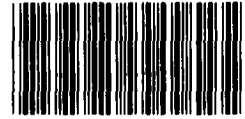
BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

IMPROVING THE COLLECTION OF DEBTS
OWED THE GOVERNMENT

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Mr. Chairman and Members of the Committee:

We are here today at your request to discuss our work in reviewing HUD's debt collection program. We will discuss the preliminary results of our ongoing review of the financial controls over HUD's Home Improvement Program (Title I). This review was requested by Senator Percy. We will also discuss our report on the serious financial weaknesses in the Department of Education's Law Enforcement Education Program. These reviews demonstrate the need for major improvements in agency debt collection programs and the need for better financial information through improved accounting systems. Adequate financial controls and records are an integral part of agencies' debt collection efforts.

Yesterday, the Comptroller General testified before you on the need for improving Government debt collection operations. He addressed the magnitude of the problem and the status of

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Government debt collection issues. He expressed his support for the proposed Debt Collection Act of 1980 (S3160) and outlined additional ways in which Federal agencies can improve their debt collection operations. The effectiveness of the initiatives the Comptroller General outlined to you depends on the development of good accounting systems which provide necessary financial controls and accurate records.

As the Comptroller General pointed out yesterday, debts owed the Government have been enormous and the inventory of debts owed is growing, with agencies reporting to the Treasury that \$117 billion was owed by U.S. citizens and organizations at the start of fiscal 1980--a 23 percent increase over the previous year. The expected losses on these receivables were \$6.3 billion--also a 23 percent increase over the previous year. In fiscal 1979, Federal agencies wrote off receivables valued at \$1.5 billion as uncollectible. These large write offs and the ever increasing expected losses clearly illustrate the Government's collection problems. We have identified specific weaknesses in debt collection programs and have recommended a number of specific corrective actions to improve the recording and collection of debts due the Government. Unfortunately, our recommendations have not always been implemented by the agencies. Until all Federal agencies aggressively pursue the collection of debts owed the Government, hundreds of millions of dollars will continue to be lost.

At yesterday's hearing, the Comptroller General discussed problems identified in the Federal Government's debt collection program. Today, I would like to discuss the specific

problems identified at two organizations--the Department of Housing and Urban Development and the Department of Education's Law Enforcement Education Program.

COLLECTION PROBLEMS WITH HUD'S LOAN PROGRAMS

GAO has previously reported many accounting problems at the Department of Housing and Urban Development (HUD). We first reported on accounting system problems at HUD in 1975 after reviewing the tax payment system for acquired single-family properties. At that time, HUD informed us of plans to institute a new mechanized accounting system. Since 1975, implementation dates of the new system have continually slipped and as of today the system is still not operational.

Subsequent to our 1975 report, our HUD reports include, among others, reports on HUD's accounting for Section 312 rehabilitation loans, mortgage insurance premiums (MIP), single-family mortgages and, most recently, multifamily mortgages. Even though HUD has taken some corrective actions to correct the problems noted in our many reports, HUD has generally cited the new mechanized accounting system as the ultimate remedy to the major system problems.

One problem we have noted in most of our accounting reviews at HUD is the lack of debt collection information reported by the accounting systems. This information is necessary both to serve those responsible for debt collection and to monitor their performance. Most recently, we reported on HUD's management and accounting for multifamily Secretary-held mortgages. Under this

program, HUD insures mortgages made by commercial lenders to build multifamily housing projects. When borrowers default on their payments, the mortgages are usually returned to HUD for payment of the insurance claim. After the lender is paid off, HUD becomes the owner of what now becomes classified as a "Secretary-held mortgage."

Need for overall collection data

HUD provided us statistics showing that at the time of our review, it held approximately 2,000 multifamily mortgages with an unpaid principal balance of about \$3.7 billion. Beyond these total statistics, little data was available to evaluate the success of HUD's collection efforts. Each of the 2,000 mortgages was individually accounted for but summary accounting information was not available. As part of our review, we were able to determine that over \$500 million was owed the United States for payments that had already come due under the terms of the mortgages. We developed this figure by working manually with each of the approximately 2,000 accounts. The \$500 million figure showed the severity of the collection problems at HUD and should have been readily available, along with much other detailed information, to evaluate collection efforts.

The multifamily example as well as other HUD accounting systems reflect a need for the type of accounting information required by the proposed legislation. Enactment of the legislation would place added incentive and/or a legislative requirement on HUD to both develop the data, report the data

within the internal structure of HUD as well as to OMB and constantly evaluate the success of their own collection efforts.

Status of current GAO review
of Title I loan program

At Senator Percy's request, we are currently reviewing HUD's Title I Home Improvement Loan Program. This program was established by the National Housing Act of 1934, as amended. One of HUD's oldest programs, it provides credit insurance on property improvement loans made by approved lending institutions. Since 1969 the program has also been used to finance the purchase of mobile homes. Loans are generally limited to a maximum of \$15,000 (\$27,000 for mobile homes) and must be repaid within 15 years (20 years on certain mobile homes). The maximum interest rate a lender can charge is set by HUD and currently is 15-1/2 percent.

Approved lenders must follow prudent lending practices in making loans and must pay HUD an annual insurance premium of 1/2 percent of the loan's proceeds. HUD requires that loans in excess of \$7,500 be secured with a recorded lien on the improved property. However, about 80 percent of the loans made are for less than \$7,500 and are therefore unsecured signature loans.

Lending institutions are required to obtain credit reports on loan applicants or perform credit investigations. The information must show that, in the lender's judgment,

the borrower is solvent with reasonable ability to pay the obligation. Title I regulations also generally prohibit a borrower from obtaining a loan if they are past due more than 15 days with respect to an obligation owing to, or insured by, any department or agency of the Federal Government.

When a borrower has defaulted on loan payments and full payment on the note is being demanded the lender can submit a claim to HUD for payment of the insured loss. Subject to the lender having adequate insurance reserves, HUD will generally pay 90 percent of the losses incurred by the lender.

Since inception of the program HUD has insured about \$30 billion in Title I loans and is currently insuring loans valued at over \$1 billion annually. About 6,500 lenders are participating in the program.

HUD officials informed us that the Title I program has traditionally operated at a profit, however, they were unable to provide us with formal financial statements reporting the program's operations. Title I formal financial statements are not available because the program is accounted for only as part of the FHA's general insurance fund in HUD's annual financial statements. The general insurance fund however, has been operating at a deficit. For example, in fiscal 1979 FHA reported that the general insurance fund operated at a net loss of over \$222 million. We determined from available data that in recent years the Title

I program's income from insurance premiums as well as claims paid have both been increasing and are about equal. Therefore, the dollar value of defaulted loans that HUD must service has been increasing. However, in contrast to the gradual increase in the number of defaulted loans serviced, the dollar value of loans written off as uncollectible has been increasing at an alarming rate. For example, in fiscal 1980 HUD wrote off defaulted Title I loans valued at over \$18.7 million-- a noticeable increase over the write off of \$14.6 million in fiscal 1979 and \$8 million in fiscal 1978. Furthermore, these write-offs also contribute to the \$222 million loss reported by the overall fund. The value of defaulted Title I loans currently serviced by HUD is somewhere between \$106 million and \$118 million.

Defaulted Title I loans are serviced by 57 Title I Representatives in HUD's field offices. These representatives reported that as of the end of fiscal 1980 they were servicing over 55,000 loans or a caseload of about 1,000 loans per individual. Even though the caseload is heavy we feel improvements can be made in both loan origination and loan servicing.

One problem which can lead to defaulted loans is a failure by lenders to find out about loans previously made to the same borrower. Generally, HUD does not approve Title I loans and approved lenders are not required to report Title I loans to credit bureaus.

As a result, credit reports often will not reveal the existence of prior loans. Lenders, therefore, must rely largely on the honesty of the borrower in making a loan application. Our work to date has revealed some borrowers who apparently falsified loan applications and either received multiple loans which either exceeded loan limitations or received loans while in default under previous loans.

In one example a defaulted loan was returned to HUD in 1979. The field office servicer recognized the name of the borrower and matched the loan to a previously defaulted Title I loan which had been returned in 1972. The borrower had stopped making payments to HUD in 1976 on the first loan but in 1978 obtained a second loan. Both loans are currently in default and the borrower has refused to pay. The Department of Justice declined prosecution of the case.

The extent of these types of problems is unknown because HUD has never matched the names of defaulted borrowers against one other, either within the same loan program or between different loan programs. Cases such as the one cited above are discovered only after the loan proceeds have been issued and the loans are in default. Reporting of debts to credit bureaus, as called for in the proposed legislation and supported by the Comptroller General in his testimony yesterday, could have prevented this type of problem.

Need for improvement
in accounting and servicing

Our work to date has revealed numerous loan servicing and accounting problems at HUD. As stated earlier, we realize the workload of those responsible to collect defaulted Title I loans is heavy. However, improvements in loan servicing and accounting must be made. The following problems contribute to the volume of defaulted and/or uncollectible loans and require HUD's immediate attention.

- Defaulted borrowers are charged a lower interest rate on their loans after default than they were charged when their loans were current.
- Millions are written off annually because defaulted borrowers cannot be located and every possible means of locating them has not been used.
- Judgment liens are not always obtained on collateral owned by defaulted borrowers. HUD officials could not tell us the number, dollar value, or status of the cases at Justice for civil action,
- HUD headquarters does not oversee field office servicing activities. Such oversight should include a vigorous role in approving loans written off.
- The Title I accounting system is outdated and must be modernized in order to mechanize manually performed accounting functions, including the computation of interest, provide information from

which loans can be aggressively serviced and produce periodic account statements.

--Field office servicing must be improved. Defaulted loans must be aggressively serviced immediately upon the loan's return to HUD and more systematic servicing techniques must be followed.

LAW ENFORCEMENT EDUCATION PROGRAM
HAS SERIOUS FINANCIAL WEAKNESSES

In a June 1980 report to the Congress titled "The Law Enforcement Education Program is in Serious Financial Disarray" (FGMSD-80-46), we disclosed serious accounting systems problems and the lack of a viable debt collection program. Since 1969 the Law Enforcement Education Program made over \$278 million in loans and grants to over 312,000 individuals without adequate management controls to ensure that:

- individuals repay loans when they are due,
- accurate records are maintained, and
- grants and loans are made to congressionally intended recipients.

Congress established the program in 1968 to assist those working in law enforcement or planning to work in law enforcement obtain a higher education. Grants and loans are made to individuals enrolled in law enforcement or criminal justice courses at almost 1,000 junior colleges, colleges, and universities.

Grants are made to students who are employed full time by publicly funded law enforcement or criminal justice agencies, who agree to remain so employed for at least 2 years after completing the course for which the grant was received.

If the employment criteria are met, the grant is forgiven (canceled without repayment); if the criteria are not met, the grant must be repaid, with interest. (In effect, the grant becomes a loan.) Loans are made to full-time students who are employed or who are preparing for employment in law enforcement or criminal justice. Loans may be forgiven if the recipient is employed full time by a law enforcement or criminal justice agency subsequent to completion of the course for which the loan was received. (In effect, the loan becomes a grant.)

Billing and collection weakness

The Law Enforcement Education Program did not properly bill and collect for grants and loans. Bills were inaccurate and collections reduced because of billing system errors and weak collection efforts. We estimated that at least \$18.2 million that should be collected in the next few years will not be collected unless stronger collection efforts are adopted.

Most individuals were billed for less than they owed, a few were billed for more than they owed, and others were not billed at all. We estimated that 90 percent of the bills were incorrect, usually because the computer program supporting the accounting system improperly computed interest owed or amount of payment required.

The amount of interest billed was understated by hundreds of thousands of dollars. During one 3-month period, almost 17,000 individuals were billed \$1.5 million in interest. We determined that interest charges for this period should have been about \$1.9 million--a difference of almost \$400,000.

Incorrect bills also resulted from computer program errors in determining amounts to be repaid and who should be billed. We tried to determine how and why the program malfunctioned and what corrective action was needed, but were stymied because the program is virtually undocumented. To correct the billing problems, management must have the computer program reviewed to determine why and how the errors occurred. Once found, the errors should be corrected and the program documented to facilitate future modifications and error detection.

Compounding the billing problems was the fact that few individuals paid their bills and followup collection actions were ineffective. We estimated that 84 percent of those billed did not pay or seek forgiveness by certifying that they were employed by a qualifying law enforcement agency.

Little or no effort was made to collect from those who did not pay. Individuals who did not pay continued to receive bills regularly. For example, one individual was billed six times between January 1, 1977, and April 1, 1979, and ignored all six. The only collection effort was to

continue sending bills. Nonpayers were not contacted by phone or sent letters demanding payment. We could find no cases where Justice was asked to bring legal action against delinquent borrowers.

Individuals had little or no incentive to pay their bills. If they ignored enough bills, billings may stop and collection efforts cease. Officials told us that if an individual ignored three consecutive bills, the account should be placed into default by the billing system. A bill should then be sent demanding full payment for the outstanding balance plus interest. If this bill is ignored, no additional bills should be sent and no further collection actions taken. The billing system has never consistently placed individuals into default and most nonpayers continued to be billed.

The debt collection program encouraged nonpayment of bills and caused low collections. By ignoring their bills, individuals were able to avoid repayment. There was no incentive to pay, no serious attempt to collect nor was any penalty imposed on nonpayers.

Inadequate payment processing

Payment processing was also inadequate. Payments were not promptly deposited and were poorly controlled, causing ineffective cash management and an increased potential for loss or theft. We found that:

- Payments were usually deposited between 16 and 20 days after receipt. For instance, checks totaling

\$29,000 received in June and July 1978 were not deposited until the third week of September 1978.

--Checks were not recorded as received until between 1 and 5 days after receipt; during which time, they were in an "out basket" easily accessible to everyone in the area and subject to loss or theft. This problem was particularly significant because some checks did not have a payee filled in and could be cashed easily. Once recorded, individuals handle both the checks and accounting records. This caused a breakdown of internal controls and substantially increased the potential for theft.

--Individual accounts were not promptly credited with payments. One group of 31 checks totaling \$3,300 was processed and deposited in the Federal Reserve Bank in December 1977, but the accounting system did not credit individual accounts with the payments.

Lack of control over forgiveness

In addition, forgiveness was not properly controlled. The laws governing the program provide that grants and loans may be forgiven if the recipients are employed by law enforcement or criminal justice agencies for a specified period. Individuals are regularly sent a form for certifying employment with a qualifying agency. One-third of the recipients, however, do not return the certification. In such cases, another certification form is sent usually the following year, instead of a bill. Under this procedure, recipients who never return the certification are never billed.

Accounting controls for returned certifications were inadequate. We estimated that 23 percent of the forgiveness computations were incorrect with individuals usually not receiving all the forgiveness they were entitled to. On the other hand, forgiveness has been granted for employment with agencies that have little to do with criminal justice, and an individual who asked for additional time to repay instead had his loan forgiven. The improper granting of forgiveness results in inaccurate accounting records and an overstatement of the loan receivable balance.

Inadequate reporting

The Debt Collection Act of 1980 (S-3160), discussed yesterday by the Comptroller General, will require Federal agencies to improve their accounting systems for the recording and reporting of their accounts and loans receivable balances.

The Law Enforcement Education Program did not record and report loans receivable accurately to establish and maintain effective financial control over the program. We estimated that the loans receivable balance of \$149.6 million reported for September 30, 1978, was overstated by at least \$72.4 million because allowance accounts were not established for grants and loans that will be forgiven. The balance may be further overstated because an allowance for uncollectible grants and loans was not established and there was no support for a yearend estimate of the amount of grants and loans awarded but not processed by the accounting system.

Accurate recording and reporting of loans receivable and allowances for forgiven and uncollectible grants and loans are essential if the financial position of the program is to be fairly presented. In addition, accurate accounting for loans receivable is an important control over agency resources because it provides a systematic record of amounts due.

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The problems discussed are not unique to HUD programs or to the Law Enforcement Education Program. As the Comptroller General discussed yesterday, similar problems exist throughout the Federal Government. As a result, hundreds of millions of dollars are not being collected each year. These problems will continue until Federal agencies improve their debt collection programs.

This concludes my statement Mr. Chairman. We will be pleased to respond to any questions you or other Members of the Committee may have.