United States General Accounting Office

GAO

Report to the Chairman, Committee on the Budget, U.S. Senate

September 1993

FEDERAL CREDIT REFORM

Information on Credit Modifications and Financing Accounts

149996

GAO/AIMD-93-26

GAO

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

**Accounting and Information
Management Division**

B-254746

September 30, 1993

The Honorable Jim Sasser
Chairman, Committee on the Budget
United States Senate

Dear Mr. Chairman:

Your July 14, 1992, letter asked several questions about agencies' progress and problems in carrying out the Federal Credit Reform Act of 1990 (Public Law 101-508). This letter provides information on (1) loan obligation and loan guarantee commitment modifications under credit reform and (2) control of payments from financing accounts established by the act. We previously reported to you on agencies' capabilities to account for domestic lending programs under credit reform and to calculate the federal government's cost for these programs, Federal Credit Programs: Agencies Had Serious Problems Meeting Credit Reform Accounting Requirements (GAO/AFMD-93-17, January 6, 1993). We will report to you later on the other areas you requested us to examine, including implementation of credit reform for international credit programs.

Results in Brief

While the Federal Credit Reform Act requires agencies to estimate the cost of loan obligations and loan guarantee commitments when they are modified, of the agencies reviewed, only Education had occasion to exercise this requirement. Although the Office of Management and Budget (OMB) believes the number of modifications under the act could grow, all of the agencies included in our review anticipated that modifications will probably have little applicability to their credit programs in the future. Changes to loan obligations and loan guarantee commitments for their programs can occur under credit contract terms or as a part of normal collection procedures, as was the case at the Farmers Home Administration (FmHA) and the Department of Veterans Affairs (VA). The act and OMB permit the costs associated with such changes to be included in agencies' annual cost estimates and reestimates.

Also, we found that, for the most part, agencies maintained credit reform financing accounts by using pre-credit reform financial systems and controls, which were not designed for this purpose. As a result, several agencies estimated the amounts of payments applicable to financing accounts because their financial systems could not produce this data. Estimating procedures, as well as long-standing problems in agencies' pre-credit reform financial systems and controls, can result in imprecise financing account information that could hamper oversight of financing account activities.

Background

The Federal Credit Reform Act changed the budgetary treatment of loans and loan guarantees made after fiscal year 1991. The act requires the President's budget to include the full long-term cost to the government of credit programs in the year in which the loan obligations or loan guarantee commitments are made. The act is intended to ensure that the full cost of credit programs over their entire lives is considered by the Congress as it deliberates the amount of direct loans and loan guarantees to authorize and fund each year. To help ensure that agencies know the current cost of lending operations and to provide the Congress updated cost information, agencies annually reestimate original credit program cost estimates and estimate costs resulting whenever modifications to loan obligations or loan guarantee commitments occur.

Regarding credit modifications, section 504(e) of the act provides that a direct loan obligation or loan guarantee commitment is not to be modified in a manner that increases its cost unless budget authority for the additional cost is appropriated or is available out of existing appropriations or from other budgetary resources. Further, under the act, any government action that alters the estimated net present value of an outstanding direct loan or loan guarantee (except modifications within the terms of existing contracts or through other existing authorities) is to be counted as a change in the cost of the direct loan or loan guarantee. The calculation of such cost changes is to be based on the estimated present value of the direct loan or loan guarantee at the time of modification.

Regarding financing accounts, section 505(b) of the act authorizes the establishment of such accounts in implementing the act. Section 502(7) defines financing accounts as nonbudget accounts to account for cash collections and payments for lending programs under credit reform. Other accounts to be established by the act are (1) liquidating accounts, which are budget accounts to account for cash flows for pre-credit reform direct or guaranteed loans and (2) credit program accounts, which are budget accounts into which an appropriation to cover the cost of a direct or guaranteed loan program is made and from which such costs are to be disbursed to financing accounts.

OMB provided overall guidance to agencies for calculating loan obligation and loan guarantee commitment modification cost estimates and maintaining credit reform financing accounts. The guidance was primarily issued as part of OMB Circular No. A-11, Preparation and Submission of Budget Estimates.

Objective, Scope, and Methodology

The objective of our work was to develop information on agencies' (1) calculations of the cost of modified loan obligations and loan guarantee commitments and (2) control of financing account payments. Our work was performed at the five major domestic lending agencies—the Departments of Agriculture (FmHA), Education, Housing and Urban Development (Federal Housing Administration (FHA)), VA (housing loan programs), and the Small Business Administration (SBA).

We reviewed OMB's guidance to agencies on loan obligation and loan commitment modification cost estimates and on financing accounts. At the agencies included in our review, we examined policies and procedures for credit modifications and financing accounts and discussed these areas with officials responsible for implementing credit reform. We asked the agencies to identify any modifications which required cost estimates under credit reform. Because of the high volume of loans and loan guarantee transactions the major lending agencies generate annually and the many circumstances which may modify these credit commitments, it was impractical for us to otherwise try to identify loan obligation and loan guarantee commitment modifications that may have occurred.

To gain an understanding of the agencies' financial systems operations, we obtained agencies' financial reports, reviewed financial systems documentation, observed the systems in operation, and discussed these areas with responsible agency officials. At SBA, VA, and FmHA, we examined the control processes and financing account procedures for a limited number of payment transactions. Because FHA used overall estimates to prepare financing account data, it was not possible to examine individual financing account transactions. At Education, the examination of transactions was part of our work to audit the Federal Family Education Loan Program (formerly the Guaranteed Student Loan Program) financial statements for fiscal year 1992 under the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576). At SBA, FHA, VA, and FmHA, we discussed credit reform procedures with the inspectors general staffs or independent external auditors performing financial audit work under the CFO Act.

A draft of the report was discussed with OMB officials who concurred with the information provided them. Our work was conducted between December 1992 and April 1993 and was done in accordance with generally accepted government auditing standards.

Few Modification Cost Calculations Were Required

Of the five domestic lending agencies we reviewed, only Education told us that it had credit program modification situations which required cost calculations. These modifications stemmed from changes in law. Education's representatives told us that, except possibly for loan sales involving the Department's construction loan program, Education generally did not expect future loan obligation and loan guarantee commitment modifications that would require cost estimates. Also, the officials from the other agencies we visited advised us that their agencies' credit programs do not generally involve actions that are modifications requiring cost estimates. OMB representatives told us that most modifications under the act have occurred in international credit programs, which were outside the scope of this review, and that instances of loan obligation and loan guarantee commitment modifications requiring cost estimates could grow.

However, representatives of FmHA and VA advised us that changes can occur under the terms of existing loan contracts and under routine administrative collection procedures, such as refinanced loans, anticipated repurchases of loans, and other expected changes. Under the act and OMB's guidance, the expected effects on the cost of these types of loan obligation and loan guarantee commitment changes are permitted to be included in agencies' annual estimates of cash flow that are included with agencies' budget requests. If the expected effects do not occur and more (or fewer) actions of this type occur than had been estimated, the revised expectation of cash flow is to be included in agencies' annual cost reestimates. Agencies advised us that OMB was generally consulted when they were uncertain as to whether specific loan obligation and loan guarantee commitment changes constituted modifications requiring cost estimates under the act.

Education's Modifications Required Cost Calculations

In consultation with OMB, the Department of Education recalculated its fiscal year 1992 guaranteed student loan costs as a result of two new laws affecting the collection of these guaranteed loans. OMB's credit reform guidance provides that an agency's latest annual cost estimate is to be recalculated when legislative actions change an agency's collection procedures.

To offset the additional costs associated with the extension of unemployment benefits in 1991, the Congress provided permanent legislative authorities to increase the collection primarily of guaranteed student loans. Specifically, the Emergency Unemployment Compensation Act of 1991 (Public Law 102-164) authorized Education to garnish disposable pay to collect defaulted student loans. The act also provided agencies, including Education, permanent authority to collect delinquent debts through the offset of tax refunds. Also, the Higher Education Act Amendments of 1992 (Public Law 102-325) extended the statute of limitations for collection of defaulted student loans.

Financing Accounts Were Maintained Using Pre-Credit Reform Financial Systems and Controls

The establishment of financing accounts under credit reform placed on already deficient agency credit program financial systems new accounting and financial reporting requirements, which the systems could not handle. As a result, several agencies used various estimating procedures to generate financing account information. These practices, along with the credit agencies' pervasive and long-standing financial systems problems which we have extensively reported on, hamper oversight of financing account activities. Such oversight is important to help ensure that the activities agencies funded out of the financing accounts were limited to those activities for which the original credit program cost estimates were calculated.

Agencies' Financing Account Control Practices Varied

The agencies we reviewed generally had not substantially changed their financial systems and controls to implement credit reform. Except at FmHA and SBA, we found that the financial information in agencies' financing accounts was not directly relatable to the results of individual transactions, which would help ensure the reliability of the data. Instead, to accommodate the pre-credit reform financial systems, several agencies maintained financing account information primarily by using estimated, adjusted, or consolidated amounts. Specific examples follow.

- FHA estimated its financing account balances based on historical analysis and a summary of transactions processed through FHA's pre-credit reform financial system. In audits of FHA's financial statements under the CFO Act, the amounts FHA records in accounts it established to fulfill the act's requirements are subject to examination by an independent external auditor.

- Education estimated its financing account balances based on guaranteed student loan data reported from the Department's 46 guaranty agencies.[1] As the next section discusses, Education does not have the necessary controls to ensure that guaranty agencies' information is accurate.
- At VA, credit program payments were first recorded in one of VA's housing program liquidating accounts. Then, transactions related to loans dated on or after October 1, 1991, (credit reform loans) were automatically consolidated and allocated to one of VA's housing program financing accounts. However, payment data related to loans acquired after October 1, 1991, when credit reform began, were not transferred from the liquidating accounts to the financing accounts because the system was not designed to establish a new loan date for these loans. Due to this problem, to prepare VA's fiscal year 1994 budget, a $3.3 million adjustment was made to the financing accounts to cover obligations for 51 loans acquired in fiscal year 1992. VA representatives told us that VA plans system changes that will correct this problem.

Agencies' Credit Program Financial Systems Had Long-standing Problems

We reported to you in January 1993 that lending agencies had major financial systems and accounting deficiencies which preceded the Federal Credit Reform Act. These financial systems problems are long-standing and persistent and result in unreliable historical credit program data.

Again, for example, in March 1993, we reported[2] that Education did not have adequate controls and procedures to ensure that it received the financial information needed from guaranty agencies and lenders to effectively manage the guaranteed student loan program. In addition, we reported that Education could not ensure that billions of dollars in payments made annually to guaranty agencies and lenders were proper or that financial information on the guaranteed student loan program operations was accurate.

Agencies' financial systems problems, such as those at Education, can affect the accuracy and reliability of credit reform financing account information. Also, when individual transactions are not processed through, or directly relatable to, agencies' financing accounts, it is not possible to

[1]Under the guaranteed student loan program, Education pays interest subsidies directly to lenders and reimburses them for loan defaults directly or through state and nonprofit guaranty agencies.

[2]Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993).

determine whether the activities agencies charged to the accounts were limited to those used to calculate the original cost estimates. Also, as we reported to you in January 1993, the agencies' original cost estimates have great and sometimes unavoidable, potential for inaccuracy due to such factors as uncertain economic conditions and unreliable historical data.

These factors hinder the ability of agencies' managers and the Congress to analyze, based on accurate and reliable information, the results of payments charged to these accounts in relation to credit program cost estimates prepared for the budget. However, this kind of analysis is important to ensure that agencies do not use financing accounts, which are excluded from the budget, to fund credit program costs without congressional oversight and without reporting the costs in budgetary outlay totals.

Our work to trace a limited number of payment transactions through credit program financial systems to financing accounts at VA (housing), SBA, and FmHA showed the following. Our attempt at VA to trace seven payments was impeded because (1) we could no longer identify three of the transactions because they were consolidated with other transactions for transfer from a liquidating account to a financing account and (2) two transactions related to acquired loans which, as previously discussed, remained in VA's liquidating account. We were able to trace the two remaining VA transactions from their initial invoices to the proper financing account. At SBA, we traced one payment for the care and preservation of collateral directly to a financing account, and, based on observations involving seven loan-related transactions, found SBA's control environment to be adequate. At FmHA, we found that each of the 15 payments we traced to the financing account were properly approved and charged to the account.

We anticipate closer examination of the reliability of agencies' financing account and other credit reform account balances to result from audits of credit agencies' financial statements under the CFO Act. In June 1993 we reported[3] on Education's Federal Family Education Loan Program fiscal year 1992 financial statements and, at the time of our visits to the other agencies, financial statement audits by agencies' inspectors general or independent external auditors were underway as well.

[3]Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992, (GAO/AIMD-93-04, June 30, 1993).

Conclusions

Calculating the cost of loan obligation and loan guarantee commitment modifications and maintaining financing accounts were among the many new accounting and reporting requirements placed on agencies by the Federal Credit Reform Act. Although agencies had not widely experienced the need to calculate the cost of loan obligation and loan guarantee commitment modifications, this is an important aspect of credit reform for budgetary purposes. Further, for the most part agencies did not update their financial systems or establish new payment control procedures to accommodate the financing accounts the act established. Instead, several agencies used pre-credit reform financial systems and controls and made estimates, adjustments, or consolidations to provide financing account data, which can affect the accuracy and reliability of this information.

We are sending copies of this report to the Director of the Office of Management and Budget; the Secretaries of Agriculture, Education, Housing and Urban Development, and Veterans Affairs; the Administrator of the Small Business Administration; interested congressional committees; and other interested parties. Please contact me at (202) 512-9454 if you or your staff have any questions concerning this report.

Sincerely yours,

Jeffrey C. Steinhoff

Jeffrey C. Steinhoff
Director, Civil Audits

Ordering Information

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

Orders by mail:

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

or visit:

Room 1000
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

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