United States General Accounting Office

GAO

Report to the Honorable John R. Kasich, House of Representatives

April 1990

# CREDIT MANAGEMENT

# Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program

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

**Accounting and Financial**
**Management Division**

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April 16, 1990

The Honorable John R. Kasich
House of Representatives

Dear Mr. Kasich:

As you requested, this report provides information on federal agencies' changes in receivable information between fiscal years 1985 and 1988 and describes the results of our review of selected federal agencies' activities to implement OMB's nine-point credit management program. Our review showed that while the administration and federal agencies are placing increased emphasis on credit management, and progress has been made in implementing the nine-point program, the government's credit picture continues to deteriorate. Agencies could further improve their credit management programs by fully implementing credit management techniques set forth in OMB and Treasury guidance. OMB agreed with this conclusion and concurred with GAO that legislative changes are needed to help ensure a more consistent application of the nine-point program.

The report contains recommendations to the Congress for (1) amending the Debt Collection Act to require agencies, where consistent with program legislation, to use certain credit management tools which are now optional and (2) requiring agencies to provide it annually with audited financial information on their receivables and delinquencies. The report also makes recommendations to the agencies for improving their credit management programs.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send copies to the President of the Senate; the Speaker of the House of Representatives; the Director of the Office of Management and Budget; the Secretaries of Agriculture, Education, Housing and Urban Development, Veterans Affairs, and the Treasury; the Administrator of the Small Business Administration; the Commissioner of the Internal Revenue Service; and other interested parties. Copies will also be available to others on request.

This report was prepared under the direction of Jeffrey C. Steinhoff, Director of Financial Management Systems Issues, who may be reached on 275-9454 if you or your staff have any questions. Other major contributors are listed in appendix XI.

Sincerely yours,

Donald H. Chapin
Assistant Comptroller General

# Executive Summary

## Purpose

Delinquent debts owed to the federal government remain high and the government's risk of loss on receivables and guaranteed loans continues to grow. While loan receivables decreased 13 percent between fiscal years 1985 and 1988, delinquencies increased 33 percent—from $14.6 billion to $19.5 billion. In addition, outstanding guaranteed loans increased 34 percent between fiscal years 1985 and 1988—from $410 billion to $550 billion while defaulted guarantees increased by 84 percent.

At the request of Representative John R. Kasich, GAO reviewed activities to implement the Office of Management and Budget's (OMB) credit management program for selected programs at the five primary credit agencies—the Departments of Agriculture, Housing and Urban Development (HUD), Education, and Veterans Affairs and the Small Business Administration (SBA). These agencies account for 67 percent of the government's loan receivables and 85 percent of its loan delinquencies. They also account for 94 percent of the government's outstanding loan guarantees. (It should be noted that in addition to direct and guaranteed loans, the government provides over $4 trillion in other types of credit assistance and insurance.) This report identifies changes, and reasons for changes, in these agencies' direct and guaranteed loan data between fiscal years 1985 and 1988; evaluates agencies' progress and problems in implementing the administration's nine-point credit management program; and makes recommendations for improvements.

## Background

The federal government lends or guarantees loans for billions of dollars for a wide variety of programs, such as housing, farming, education, and small businesses. At the end of fiscal year 1988, federal agencies reported about $224 billion in loans receivable and $550 billion in guaranteed loans outstanding.

Because federal loans are made to accomplish congressionally mandated objectives and are often made to borrowers who cannot obtain private financing, agencies are faced with balancing social and economic goals and good credit management practices. Also, in many cases, the government's risk in making these loans is often much greater than private lenders are willing to bear.

Federal agencies have long had problems in managing their credit programs. These problems, which have drawn increased attention because of the huge federal deficit, have been highlighted in reports by GAO, inspectors general, and others over the past decade. To help combat this situation, OMB placed a high priority on credit management and, in 1986, initiated a nine-point program to improve agencies' credit management practices. This is a comprehensive credit management policy for improving debt collection, reducing delinquencies, and improving the management of receivables by focusing on nine initiatives in the credit cycle. The nine-point program involves (1) screening of loan applicants, (2) maintaining files, (3) selling loans, (4) reporting to consumer reporting agencies, (5) using collection firms, (6) offsetting federal income tax refunds, (7) offsetting federal employees' salaries, (8) litigating debts, and (9) writing off delinquent debts.

## Results in Brief

Historically, the full magnitude of the government's credit picture was not readily discernable because some agencies did not fully report delinquencies. Although the administration and federal agencies are placing increased emphasis on credit management, and progress has been made in implementing OMB's nine-point program, the government's credit picture has continued to deteriorate over the past 3 years. Some of this deterioration can be attributed to economic conditions in the farm and energy economies. If these conditions continue or develop in other segments of the economy, the government's credit picture could further deteriorate. Also, deterioration of the government's credit picture compounds the budget deficit.

In some instances, agencies GAO reviewed had not fully implemented several loan origination, account servicing, collection, and write-off initiatives as specified in OMB's nine-point program and as generally allowed by the Debt Collection Act of 1982. For example, agencies are not adequately screening applicants for delinquent federal debt, and, in some instances, they are not using private collection firms in the normal collection process. GAO believes that not using these tools contributes to the rise in delinquencies and adversely affects the government's ability to make collectible loans and to collect on outstanding loans. Although OMB has established a sound credit management program and both OMB and Treasury instruct agencies to use the nine-point program credit management tools, agencies are not legislatively required to do so. Credit management programs for the agencies GAO reviewed would be improved if the Congress legislatively required the use of many of these initiatives. Such legislation would also help maintain the past decade's momentum in improving the government's credit management. GAO also believes that credit management programs would be improved if agencies provided the Congress audited financial information on their receivables and delinquencies as well as information on their collection efforts. The Congress could use these data when making budgetary decisions.

# Principal Findings

## Credit Picture Deteriorating and Worse Than Reported

Federal agencies reported that delinquent loans have increased between fiscal years 1985 and 1988, even though receivables have declined. Delinquent loans as a percent of loans receivable increased from 6 percent in fiscal year 1985 to 9 percent in fiscal year 1988. Delinquent loans are those loans for which the borrower has failed to pay the obligated amount by the specified due date. The amount reported as delinquent is usually the payment or payments past due. Treasury instructions require that for those loans which are more than 180 days past due, the entire amount of the loan—not just the missed payments—be reported as delinquent. Because this requirement is sometimes not complied with, federal agencies' financial reports do not always accurately disclose the deteriorating credit picture. In particular, GAO estimates that the Farmers Home Administration and the Small Business Administration understated loan delinquencies by about $9.5 billion and $0.2 billion, respectively, for fiscal year 1988 because they generally did not report as delinquent the entire amount of loans past due over 180 days. Instead they showed only the missed payments as delinquent. Both these agencies modified their reporting, as of June 30, 1989, to comply with Treasury instructions. In addition, during this period, guaranteed loans increased 34 percent and defaulted guarantees increased 84 percent.

## Sound Credit Management Framework Not Fully Implemented

OMB's emphasis on the credit management problem has resulted in a sound credit management framework which is set forth in the nine-point program and OMB and Treasury guidance. Over the past several years, federal agencies have made progress in certain credit management areas, such as screening loan applicants, servicing loan accounts, and implementing delinquent debt collection tools. For example, (1) Treasury issued guidance for agencies to follow in carrying out their credit management programs, (2) HUD developed a system to screen loan applicants to determine if they had previously defaulted on other HUD-insured loans, (3) SBA, HUD, and Education each consolidated some servicing and collection activities, which resulted in improved credit management, and (4) the major credit agencies are generally participating in the tax refund offset program, which resulted in collection of $872 million over the past 3 years. However, much remains to be done to ensure that a comprehensive governmentwide credit management program is fully implemented.

One of the most significant problems is that the agencies GAO reviewed are not using all available tools, suggested in OMB and Treasury instructions, which would help ensure implementation of the nine-point program. In particular, prior to extending credit, agencies were not cross-checking with the Internal Revenue Service (IRS) to determine if a loan applicant is delinquent in paying taxes. Screening of loan applicants is an important step of the credit management cycle because collectibility of debt is often directly impacted by the effectiveness of agencies' credit extension practices. In addition, other credit management practices suggested by OMB and Treasury were not fully implemented by agencies GAO reviewed. For example, in some instances, agencies were not

- requiring that applicants be denied credit if they owed a delinquent federal debt;
- adequately monitoring private lenders whose loans were guaranteed;
- fully utilizing, in the normal course of the collection process, private collection firms;
- charging interest, penalties, or administrative costs as required by the Debt Collection Act;
- following appropriate write-off procedures; or
- reporting closed-out accounts to IRS as income to the debtor.

Those agencies GAO reviewed, which had not fully implemented the nine-point credit management program, cited various reasons for not doing so. These reasons consisted of automated system limitations, legislative restrictions, decisions not to implement because of an agency's belief that a certain credit management tool would not be consistent with the program's purpose, and failure to revise regulations and procedures.

## Recommendations

GAO is recommending that agencies fully implement specific credit management initiatives provided by the administration's nine-point program.

GAO is also recommending that the Congress amend the Debt Collection Act to require agencies, where consistent with program legislation, to utilize provisions of the act which are now optional and other credit management techniques. In addition, GAO is recommending that the Congress require agencies to provide it annually with audited financial information on their receivables and delinquencies. The Congress could use this information when making budgetary decisions to supply new funds.

## Agency Comments

OMB agreed with the main thrust of the report that agencies need to do much better in their management of credit, especially the originating and servicing of loans and collecting of delinquent debts. OMB expressed concern over rising delinquencies and defaults and over certain agencies' minimal level of compliance or their noncompliance with the program. OMB also agreed with the need for legislative changes to help ensure a more consistent application of the nine-point program. Treasury believes the report will be helpful in maintaining pressure to improve governmentwide credit management. While Treasury's Financial Management Service agrees that some legislative changes are needed, it does not believe that all the legislative recommendations proposed by GAO are necessary. Further, IRS opposes the use of taxpayer consent forms to obtain tax information on applicants for federally provided or guaranteed loans. GAO disagrees and believes that the legislative recommendations presented in this report would strengthen the government's credit management program. The major lending agencies included in GAO's review generally agreed that more needs to be done to improve credit management. They also generally agreed with the improvements recommended. Some agencies stated that they are now addressing some of GAO's recommendations while, in other instances, the agencies believe that their current procedures or practices are adequate. GAO's analysis of agency comments, however, showed that these procedures do not always adequately respond to the problems cited in this report. (See chapters 3, 4, and 5.)

Both OMB and Treasury believe that agencies need to improve their financial reporting systems. OMB strongly supports the report's conclusion that more needs to be done to improve loan servicing through upgraded financial systems. Also, OMB agreed with GAO's recommendation that the Congress require agencies to annually provide it with audited financial information on their receivables and delinquencies.

# Contents

## Glossary



## Tables



**Abbreviations**

| | |
|---|---|
| CAIVRS | Credit Alert Interactive Voice Response System |
| FmHA | Farmers Home Administration |
| GAO | General Accounting Office |
| GSA | General Services Administration |
| HUD | Department of Housing and Urban Development |
| IRS | Internal Revenue Service |
| OMB | Office of Management and Budget |
| SBA | Small Business Administration |
| VA | Department of Veterans Affairs |

# Introduction

The federal government lends or guarantees loans of billions of dollars for a wide variety of programs, such as for housing, farming, education, and small businesses. At the end of fiscal year 1988, federal agencies reported that loans receivable totaled $224 billion, of which $19.5 billion was delinquent. This represents a decrease of 13 percent in loans receivable and an increase of 33 percent in delinquent loans since fiscal year 1985. In addition, the percentage of the government's loans receivable which were delinquent increased from 6 percent at the end of fiscal year 1985 to 9 percent at the end of fiscal year 1988. Also, between the end of fiscal years 1985 and 1988, loans guaranteed by the federal government, which represent potential government liabilities, increased 34 percent—from $410 billion to $550 billion. In addition to direct and guaranteed loans, the government provides over $4 trillion in other types of credit assistance and insurance. Further, the government's need to effectively manage its credit programs has become acute, considering the growing federal deficits over the past several years.

Because of his continuing concern over the increasing delinquent debt owed to the federal government, Representative John R. Kasich requested that we analyze and determine the reasons for changes in the primary lending agencies' credit picture over the past 3 years. He also asked that we review federal agencies' progress in implementing the administration's credit management program. This report addresses (1) changes in the primary federal lending agencies' loan receivables, loan delinquencies, and guaranteed loans and (2) agencies' progress and problems in implementing the Office of Management and Budget's (OMB) nine-point credit management program.

The majority of the government's credit is disbursed or guaranteed through five lending agencies—the Departments of Agriculture, Education, Housing and Urban Development, and Veterans Affairs, and the Small Business Administration. These agencies' credit programs include farmer, education, housing, small business, and disaster loans.

Some of the federal government's credit management problems can be attributed to the nature of the loans. Specifically, because federal loans are made to accomplish congressionally mandated objectives and are often made to borrowers who cannot obtain private credit, agencies are faced with balancing social and economic goals and good credit management practices. Also, in many cases, the government's risk in making the loans is often much greater than private lenders are willing to bear. However, agencies have had long-standing credit management problems.

We have stated in a 1986 report,[1] that one of the major impediments to effective management of the government's debts is agencies' failure to aggressively implement procedures which would more fully utilize available credit management tools. That report concluded that agency credit management efforts are also hampered by accounting systems which do not provide managers with current and accurate information on the status of debts owed to the government.

Since the late 1970s, we issued numerous reports which were instrumental in raising the Congress' and the administration's awareness of the credit management problem. The recommendations in these reports centered around the need for the government to use commercial practices to a greater extent to collect its delinquent debts and to improve accounting for its receivables.

## Efforts to Improve Credit Management

The Congress' and the administration's concern over the increasing amount of delinquent debts owed to the federal government caused increased focus, over the past several years, on managing the government's credit activities. This resulted in credit management legislation and increased emphasis by the administration.

One of the most significant pieces of credit management legislation was the Debt Collection Act of 1982. This act, which legislated many of GAO's previous recommendations, clarified federal agencies' authority to use collection tools available in the private sector. Also, in 1981, the administration made debt collection a priority and designated OMB as the focal point for debt collection initiatives.

Since 1982, the Congress passed additional legislation to strengthen federal agencies' credit management programs. Some of the most significant legislation included authority to use private sector attorneys and the withholding of tax refunds to collect delinquent federal debts.

Also, OMB and the Department of the Treasury became more aggressive in the credit management area. In March 1983, OMB issued Bulletin 83-11, instructing agencies to update their debt collection plans to show how they will implement the Debt Collection Act. Additional guidance was provided in August 1984 when OMB revised Circular A-70, "Policies and Guidelines for Federal Credit Programs." This circular provided

[1] Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

guidance to agencies in proposing new credit programs and reviewing existing credit programs for the purpose of suggesting changes and establishing or adopting management policies. In May 1985, OMB issued Circular A-129, "Managing Federal Credit Programs," which prescribes policies and procedures for managing federal credit programs and collecting receivables. In addition, in 1986, OMB and Treasury agreed that Treasury would be primarily responsible for overseeing agencies' activities to carry out the administration's credit management initiatives while OMB would continue to establish credit management policy.

In 1986, we reported on federal agencies' efforts to implement the Debt Collection Act of 1982. (See footnote 1.) While we concluded that federal agencies had been slow in using tools which the act provided, the report pointed out the emphasis OMB placed on the credit management area and the increased role in federal credit management being taken by Treasury. Since that time, OMB and Treasury have continued to focus on the government's credit management problem. Despite these efforts, the government's credit picture continued to deteriorate, as discussed later in this report.

Recently, both OMB and Treasury have provided credit management guidance. In November 1988, OMB revised Circular A-129 which expanded on and clarified guidance presented in an earlier version. Also, as part of its Treasury Financial Manual, Treasury issued credit management guidance entitled Managing Government Credit: A Supplement to the Treasury Financial Manual. This supplement, issued in January 1989, consolidates and expands earlier Treasury credit management guidance into a comprehensive credit management document.

## OMB's Nine-Point Credit Management Program

OMB's increased emphasis on credit management, beginning in the early 1980s, has resulted in a comprehensive credit management policy intended to improve debt collection, reduce delinquencies, and improve the management of receivables. In August 1986, OMB instructed agencies to follow a nine-point credit management program to help ensure implementation of this policy. The nine-point program focuses on credit management initiatives in each of the credit cycle phases—loan origination, account servicing, collections, and write-offs. The nine-point program instructs agencies, unless prohibited by legislation, to implement initiatives under each of the credit cycle phases. Specific requirements follow.

## Loan Origination Phase

- Credit applicants are to be screened to determine their credit worthiness and financial responsibility, and whether they owe delinquent debts to the federal government. If the applicant owes a delinquent federal debt, loan approval is to be withheld until repayment or other arrangements have been made.

## Account Servicing Phase

- Using modern business practices and automation, agencies are to establish proper maintenance of files and the proper review and management of accounts.
- Agencies are to sell loans to the public without recourse to the federal government.

## Loan Collection Phase

- Information on commercial and delinquent[2] consumer accounts is to be reported to credit bureaus.
- Effective collection functions are to be established and private collection firms are to be used to recover seriously delinquent accounts.
- Information on delinquent debtors is to be referred to the Internal Revenue Service (IRS) so that federal income tax refunds may be offset.
- Salaries of federal employees who owe delinquent federal debts are to be offset.
- Agencies are to use litigation to collect seriously delinquent debts.

## Write-off Phase

- Uncollectible accounts are to be written off, and closed out debt is to be reported to IRS as income to the debtor.

# Objectives, Scope, and Methodology

Representative John R. Kasich requested that we analyze changes in the government's loan data between the end of fiscal years 1985 and 1988 and evaluate the primary lending agencies' credit management activities. Specifically, our objectives were to (1) identify and determine reasons for increases and decreases in the amount of agencies' loan receivables, delinquencies, write-offs, guaranteed loans outstanding, and terminations for default between the end of fiscal years 1985 and 1988 and (2) evaluate agencies' progress in implementing OMB's nine-point credit management program.

[2]Delinquency is the failure of the debtor to pay an obligation or debt by the date specified in the initial written notification or applicable contractual agreement or to make other satisfactory payment arrangements.

Our review focused primarily on the following programs:

- The Department of Agriculture's Farmers Home Administration's (FmHA) Rural Housing Program. Under this program, FmHA makes (1) Single Family Housing loans to very low, low, and moderate income families to purchase or repair homes in rural areas and (2) Multifamily Housing loans to provide moderate cost rental housing to persons of very low, low, and moderate incomes in rural areas.
- The Department of Education's Stafford Student Loan and Perkins Loan programs. Under the Stafford Loan program, Education provides re-insurance[3] to state and nonprofit agencies which guarantee loans made by lenders. There are three types of individual student loans under this program: Stafford, Supplementary Loans for Students, and Parent Loans to Undergraduate Students. Under the Perkins Loan Program, participating schools make loans to students from revolving funds consisting of federal and school funds.
- The Department of Housing and Urban Development's (HUD) Federal Housing Administration's Title I, Single Family Housing, and Multifamily Housing loan programs. The Title I program insures private lenders against losses for financing purchases such as manufactured (mobile) homes and property improvements. The Single Family Housing program insures mortgages on one- to four-family housing units. The Multifamily Housing program insures mortgages on projects such as rental properties of five or more units and nursing homes.
- The Small Business Administration's (SBA) Small Business and Disaster Loan programs. Under the Business Loan program, SBA provides direct loans or guarantees loans made by private lenders to small businesses. Through its Disaster Loan program, SBA provides direct loans to businesses and homeowners who suffer uninsured losses as a result of natural disasters.
- The Department of Veterans Affairs' (VA) Guaranty and Vendee Loan programs. Under the Loan Guaranty program, VA guarantees loans made to veterans and service personnel to purchase, construct, or improve homes. Through the Vendee Loan program, VA makes direct loans to purchasers of VA owned houses acquired because of defaults on guarantee loans.

[3]Under the Stafford Student Loan program, loans are insured by states or private guaranty agencies. Upon default, if the debt cannot be collected, the lender is reimbursed by the guaranty agency, which, in turn, may be reimbursed by Education. The guaranty agency is then responsible for collecting the defaulted loan from the borrower and remitting a portion of the proceeds to Education.

The above programs were selected because they accounted for 22 percent of the government's loan receivables and 55 percent of its delinquencies as of September 30, 1988. In addition, they accounted for 92 percent of the outstanding loans guaranteed by the federal government at the end of fiscal year 1988 and 93 percent of the defaulted guarantees during fiscal year 1988.

The majority of FmHA's delinquencies are generated through its farm loan programs. While we included farm program information in our analysis of the changes in receivable data between fiscal years 1985 and 1988, we did not include FmHA's farm program in our evaluation of agencies' efforts to implement the nine-point credit management program. We excluded the farm program (1) because of Congressional action and FmHA's interpretation of court decisions which have restricted the agency's use of certain credit management tools for these programs, such as the use of administrative offset to withhold federal payments to FmHA borrowers and foreclosing on delinquent accounts and (2) because, in February 1989, we issued a report on FmHA's farm loan-making policies and procedures.[4]

To obtain an understanding of each agency's credit management activities, we reviewed and analyzed agencies' policies, procedures, and regulations for making, servicing, collecting, and writing off loans. We also reviewed pertinent agency, OMB, and Treasury documents related to the credit management area. These included guidelines provided to agencies on specific credit management issues, such as writing off delinquent debts.

To determine the agencies' progress in implementing the various initiatives of the credit management program, we interviewed officials responsible for each agency's credit management program. This included officials responsible for the agencies' policies and procedures for making, servicing, collecting, and writing off loans. We also interviewed OMB and Treasury officials responsible for monitoring agencies' progress with the credit management program. In addition, we reviewed agency and Treasury progress reports on the credit management program. We also reviewed and analyzed the results of agency credit management reviews held by Treasury and OMB.

[4] Farmers Home Administration: Sounder Loans Would Require Revised Loan-Making Criteria (GAO/RCED-89-9, February 14, 1989).

We reviewed pertinent inspector general reports and, where appropriate, discussed credit management issues with responsible program and inspector general officials. In addition, we reviewed September 1988 and March 1989 reports of the President's Council on Integrity and Efficiency on agencies' credit management activities involving guaranteed loans. We also reviewed and drew upon information in other GAO reports involving credit management and the agencies' Financial Integrity Act reports.[5]

To determine the amount of changes in receivables, guaranteed loans, delinquencies, and write-offs over the past 3 years, we analyzed unaudited receivable information agencies reported to Treasury and OMB. We also reviewed and analyzed OMB analyses of these reports and, where appropriate, compared the information reported by agencies to their audited financial statements. We discussed the reasons for discrepancies noted and for changes in receivable information over the period covered with agency, OMB, and Treasury officials.

We performed our fieldwork from July 1988 through June 1989 in accordance with generally accepted government auditing standards. We conducted our work at the Washington, D.C., headquarters offices of the five primary lending agencies, OMB, and Treasury. To obtain a general understanding of how they made, serviced, and collected loans, we visited VA's Washington Regional Office, SBA's Washington District Office, and FmHA's Frederick (Maryland) County Office. We did not evaluate the agencies' implementation of the credit management program at the field office locations.

We obtained official agency comments on a draft of this report from the Office of Management and Budget; the Department of Treasury's Financial Management Service; the Internal Revenue Service; the Departments of Agriculture, Education, Veterans Affairs, and Housing and Urban Development; and the Small Business Administration.

Chapter 2 provides loan data for the federal government and the primary credit agencies and shows changes in this information between the end of fiscal years 1985 and 1988. Chapters 3 through 5 summarize the

[5]The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512) requires agencies to report material weaknesses in agency internal control and accounting systems to the President and the Congress each year, along with plans to correct the problems.

primary credit agencies' progress in implementing OMB's credit management program. Chapter 6 addresses the need for credit management legislation.

# Government Credit Picture Continues to Deteriorate

Historically, federal agencies have experienced problems in accounting for, controlling, and reporting on debts owed the government. In October 1978, we reported that the government's debt collection efforts had been hindered by inaccuracies in accounting for and reporting of accounts receivable. In 1986, we again reported that federal agencies had serious and long-standing problems in the collecting and accounting for debts and that delinquent receivables had increased greatly in the prior 3 years. Despite recent efforts by OMB, Treasury, and the federal agencies to improve credit management, the government's overall credit picture, as well as the credit situation at four of the agencies we reviewed, continues to deteriorate. Further, the government's credit picture is worse than reported because two agencies underreported delinquencies.

The government's deteriorating credit condition is evidenced by several factors. Specifically, while loans receivable reported by agencies decreased between fiscal years 1985 and 1988, primarily as a result of increased write-offs and a shift from direct to guaranteed loans, (1) loan delinquencies increased 33 percent, (2) delinquent loans as a percentage of loans receivable increased from 6 percent to 9 percent, and (3) guaranteed loan terminations for default increased 84 percent while guaranteed loans outstanding increased 34 percent. In addition, while the percentage of loans that were rescheduled increased slightly between fiscal years 1985 and 1988, the percent of rescheduled loans which returned to delinquent status rose sharply from 2 percent in fiscal year 1985 to 10 percent in fiscal year 1988.

The credit picture of the agencies we reviewed, except for SBA, deteriorated in that delinquencies and terminations for default between fiscal years 1985 and 1988 increased at a greater rate than loans receivable and guaranteed loans outstanding. Other indicators of this worsening situation include (1) FmHA allowances for loan and interest losses of about $23 billion at the end of fiscal year 1988, (2) large percentage increases in Education's, HUD's, and VA's reported delinquencies between fiscal years 1985 and 1988, (3) guaranteed loan terminations for default at VA and HUD, increasing 5 times and 3 times, respectively, the rate of increase of these two agencies' outstanding guaranteed loans, and (4) VA's need for increased funding of about $3 billion, since 1980, to cover loan losses.

At the end of fiscal year 1988, the government's credit picture was worse than reported because FmHA and SBA understated delinquencies by about $10 billion—50 percent of the total loans receivable delinquencies reported for the entire federal government. This underreporting, which was caused by failure to follow Treasury instructions for reporting delinquent loan data, masks the severity of the delinquent loans owed to the government. Accurate and consistent reporting of financial information pertaining to direct and guaranteed loan programs is necessary to reflect an accurate credit picture and, therefore, help policymakers such as the Congress and the administration make credit management decisions.

## Major Loan Indicators Show Problems in the Government's Credit Picture

Treasury and OMB require federal agencies to annually submit financial reports summarizing their direct and guaranteed loan programs. These reports include the major indicators of the programs' credit management picture and information from them is used by the Congress, OMB, and Treasury in monitoring and overseeing agencies' credit management activities. Specifically, the indicators of the government's credit picture include loans receivable, loan delinquencies, loan write-offs, guaranteed loans outstanding, and terminations for default. While the amounts for each of these indicators are reported separately, several are related. These indicators and how they relate to each other are described in the glossary.

**Table 2.1: Governmentwide Changes in Loan Data[a]**

Dollars in millions

| | Fiscal year 1985 | Fiscal year 1988 | Percent change |
|---|---|---|---|
| Loans receivable[b] | $258,195 | $223,944 | -13 |
| Loans receivable delinquencies[b] | 14,642 | 19,463 | 33 |
| Loan write-offs[b] | 1,180 | 21,167 | 1,694 |
| Guaranteed loans outstanding | 410,442 | 549,966 | 34 |
| Terminations for default | 6,077 | 11,195 | 84 |

[a]Amounts for loans receivable, loans receivable delinquencies, and guaranteed loans outstanding are as of the end of the fiscal year. Amounts for loan write-offs and terminations for default are totals for the fiscal year.

[b]The loans receivable, delinquency, and write-off amounts were adjusted to include VA's defaulted guaranteed loans, which VA reported as accounts receivable rather than loans receivable. According to a VA official, defaulted guaranteed loans will be reported as loans receivable in the future as required by Treasury instructions.

Source: Agencies' Reports on Accounts and Loans Receivable Due From the Public as of September 30, 1988; OMB debt collection reports; "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1987; "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1990; and the Management of the United States Government (for fiscal years 1987 and 1990).

Table 2.1 shows the governmentwide changes in reported direct and guaranteed loan data between fiscal years 1985 and 1988. In addition to the loan amounts shown in this table, federal agencies are owed interest due on loans. GAO's Policy and Procedures Manual for Guidance of Federal Agencies, Title 2, requires agencies to record interest when it is earned. Even when regular loan payments are not made, interest is to continue to be recorded until the debt is officially declared in default or a debt modification action is taken. Agencies record this interest as accounts receivable rather than as part of loans receivable. This information is not included in table 2.1 because agency financial reports sent to Treasury do not separate interest associated with loans from other types of accounts receivables, such as taxes. We were, therefore, unable to quantify the amount of loan interest recorded as accounts receivable.

Although reasons for increases and decreases in these major indicators are as varied as the individual credit programs, certain causes apply governmentwide or to several major programs. Specifically, increased loan write-offs and greater emphasis on guaranteeing loans, rather than making direct loans contributed to the decrease in loans receivable. Also, the recent economic difficulties in the agriculture and energy economies contributed to the increases in loan delinquencies. If these conditions continue or develop in other segments of the economy, the government's credit picture could further deteriorate. Also, deterioration of the government's credit picture compounds the budget deficit.

## Delinquencies and Write-offs Continue to Increase

Delinquent loans are those loans for which the borrower has failed to pay the obligated amount by the specified due date. The amount reported as delinquent is usually the payment or payments past due. In 1986, we reported that between 1982 and 1985, delinquencies increased at a greater rate than receivables. We found a similar situation during this review. As shown in table 2.1, between fiscal years 1985 and 1988, loans receivable decreased 13 percent while delinquencies increased 33 percent. In addition, during this time, loan write-offs increased by 1,694 percent, most of which was attributable to a fiscal year 1988 HUD write-off in its Low Rent Public Housing program. Appendix I shows governmentwide changes, between fiscal years 1985 and 1988, in loans receivable, delinquencies, and write-offs. OMB and Treasury officials attributed these governmentwide changes to (1) the increase in defaulted guaranteed loans as part of the government's loans receivable portfolio, (2) loan asset sales which resulted in the government selling its best loans, and (3) more accurate reporting of receivable and delinquency data by agencies.

In addition, our analysis showed that between fiscal years 1987 and 1988, the amount of delinquencies remained relatively constant. Treasury officials attributed this to the increased use of credit management tools. However, between fiscal years 1987 and 1988, the amount of loans delinquent over 360 days increased by 6 percent. This is significant because generally the longer a debt is outstanding, the more difficult the collection of that debt will be. Further, between fiscal years 1985 and 1988, delinquent loans as a percentage of total loans receivable rose from 6 percent to 9 percent.

We also found that between fiscal years 1985 and 1988, loan write-offs increased from $1.2 billion to $21.2 billion. Most of the increase is attributable to a fiscal year 1988 write-off of $17.4 billion in HUD's Low Rent Public Housing program. However, write-offs other than those associated with the Low Rent Public Housing program increased by about 223 percent. While some of this increase is attributable to economic problems in certain industries, such as energy and agriculture, OMB and Treasury officials believe that a substantial portion is a result of increased emphasis in this area by their agencies. For example, over the past several years, OMB has encouraged agencies to identify and write off uncollectible accounts and for the past 2 years has established specific annual numerical write-off goals for each major credit agency.

## Guaranteed Loans and Terminations for Default Are Increasing

Between fiscal years 1985 and 1988, terminations for default increased at more than twice the rate of guaranteed loans outstanding. During this time period, total guaranteed loans outstanding grew from $410 billion to $550 billion (34 percent). Similarly, the government's contingent liability (the amount actually guaranteed) increased 38 percent to about $459 billion in fiscal year 1988. Guaranteed loans outstanding include the total unpaid principal of the loan, even though the government may guarantee less than 100 percent. OMB includes the full principal because by guaranteeing a portion of the loan, the government helps ensure the repayment of the entire loan. Also, in programs where the federal government partially guarantees a loan, the private lender is at risk only when the value of the collateral and the guarantee combined are less than the full principal. However, except for VA, most of the loan guarantee programs guarantee close to 100 percent of the loan. As of September 30, 1988, VA's contingent liability was 44 percent of its guaranteed loans outstanding.

Guaranteed loan terminations for default also increased significantly—at a rate more than double that of the guaranteed loan increase. In fiscal year 1985, reported terminations were $6.1 billion, but they rose to $11.2 billion during fiscal year 1988, an increase of 84 percent. In fiscal year 1988, about 30 percent of the terminations for default resulted in the establishment of a direct loan by the agency, and about 65 percent resulted in the acquisition of property. Appendix II further details the changes, between fiscal years 1985 and 1988, in guaranteed loan data by major program.

## Rescheduled Loans Increased

Rescheduling a loan involves changing the existing terms of the debt to facilitate repayment. Generally, a rescheduled loan will have, at least initially, more favorable loan terms than the original agreement so that the borrower can meet his or her immediate obligations. OMB directs that rescheduling be considered only if it is in the best interest of the government and recovery of the debt is reasonably assured. Rescheduling may also be required by legislation. For financial reporting purposes, a rescheduled loan is taken out of delinquent status and returned to current status until the borrower does not meet the terms of the new agreement. Agencies separately report rescheduled loans on their Reports on Accounts and Loans Receivable Due From the Public. While they are not required to separately report the allowance for losses associated with these loans, agencies such as FmHA consider them when establishing their loss reserves.

Rescheduled loans represented a slightly greater percentage of loans receivable at the end of fiscal year 1988 than at the end of fiscal year 1985. In fiscal year 1988, 14.8 percent of outstanding loans receivable were rescheduled loans while in fiscal year 1985 the percentage was 13.1. More significantly, the number of rescheduled loans which returned to delinquent status rose sharply from 2 percent to 10 percent between fiscal years 1985 and 1988. Further, in fiscal year 1985, 3.8 percent of delinquent loans had been rescheduled at least once. By the end of fiscal year 1988, however, this increased to 18.3 percent. While we recognize that rescheduling is an acceptable practice because it may result in the recovery of all or a portion of the amount owed, rescheduling loans that later return to delinquent status can delay the use of alternative collection efforts and mask the severity of the government's potentially troubled loans.

## Credit Picture of Most Major Credit Agencies Deteriorated

Most of the government's direct and guaranteed loans are concentrated in five agencies: the Departments of Agriculture, Education, Housing and Urban Development, and Veterans Affairs, and the Small Business Administration. As of September 30, 1988, these agencies accounted for 67 percent of the loans receivable, 85 percent of loan delinquencies, 94 percent of the outstanding guarantees, and 96 percent of the terminations for default. Therefore, the effectiveness of these agencies' credit management policies and procedures has a major impact on the government's overall credit picture. As shown by several indicators in appendixes I and II and as summarized in this segment of the report, the credit situation at each of these agencies, except for SBA, deteriorated between fiscal years 1985 and 1988. In particular, except for SBA, delinquencies and terminations for default increased at a greater rate than loans receivables and guaranteed loans outstanding. This deteriorating condition is further evidenced by table 2.2 which shows the percentage of loans that was delinquent in fiscal years 1985 and 1988 for each of the five major credit agencies.

**Table 2.2: Delinquencies as a Percentage of Loans Receivable for the Five Major Credit Agencies[a,b]**

Figures in percent

| | Fiscal year | |
|---|---|---|
| **Major credit agencies** | **1985** | **1988** |
| Department of Agriculture | 3.5 | 4.4 |
| Department of Education | 22.6 | 45.8 |
| Department of Housing and Urban Development | 3.0 | 11.9 |
| Small Business Administration | 29.9 | 24.1 |
| Department of Veterans Affairs[c] | 42.7 | 57.8 |

[a]The percentages in this table were calculated from unaudited data prepared by OMB and the individual agencies. While we did not verify the amounts used to calculate these percentages, we have concerns about the reliability of some of these amounts. For example, as discussed in this report, FmHA, a major component of Agriculture, significantly understated its fiscal year 1988 delinquencies. Further, our audit of FmHA's fiscal year 1988 financial statements showed that the allowance for losses was about 32 percent of the outstanding loan principal.

[b]Those agencies which primarily guarantee loans (such as Education) will generally have a higher delinquency rate than agencies which disburse direct loans since their receivables were originally defaulted private lender loans.

[c]The loans receivable and delinquency amounts used to calculate VA's fiscal year 1985 and 1988 percentages were adjusted to include VA's defaulted guarantees which VA reported as accounts receivable rather than loans receivable.

Source: Calculated by GAO using agencies' Reports on Accounts and Loans Receivable Due From the Public as of September 30, 1988, OMB debt collection reports, and the Management of the United States Government (for fiscal years 1987 and 1990).

As mentioned previously, financial problems experienced in the farm economy are reflected in Agriculture's loan programs. Between fiscal years 1985 and 1988, Agriculture's loans receivable decreased 7.3 percent while loan delinquencies increased 15.8 percent. Also, terminations for default for Agriculture's guaranteed loan programs increased at a greater rate than outstanding guarantees.

The Farmers Home Administration's loan programs have the most acute problems in Agriculture's portfolio. While FmHA accounts for 50 percent of Agriculture's loans receivable, it accounts for 90 percent of its delinquent debt. Recent GAO reports further detail FmHA farm program loan portfolio problems.[1] For example, FmHA's fiscal year 1988 financial statements[2] disclosed that its allowances for interest and loan losses were $23.3 billion, or 37 percent of its portfolio. FmHA is currently reviewing thousands of farm program loans where the borrower requested debt restructuring as provided for in the Agricultural Credit Act of 1987. This act requires FmHA to place a priority on "writing down"[3] delinquent farm loans as an alternative to foreclosure. In March 1988, FmHA estimated that about $9 billion in write-offs would result from the application of this act.

While the Department of Education's total loans receivable decreased 26 percent between fiscal years 1985 and 1988, delinquencies increased 51 percent during the same time. More pertinent to Education, guaranteed loans outstanding increased 33 percent while terminations for default (which generally become delinquent loans receivables) increased 41 percent from $1 billion to $1.4 billion. These increases are primarily due to defaults from the large number of guaranteed loans made in the late 1970s and early 1980s, fewer federal dollars available for grant programs, increases in higher education costs, and a policy which has targeted Stafford loans to lower middle and lower income individuals. Education loans are inherently risky because they are not secured, have no creditworthiness criteria, and place little risk on the lenders, guaranty agencies, and schools.

[1] Farmers Home Administration: Loan-Servicing Efforts Focus on Continually Delinquent Borrowers (GAO/RCED-87-13BR, November 12, 1986); Farmers Home Administration: Farm Program Debt, Delinquencies, and Loan Losses as of June 30, 1987 (GAO/RCED-88-134BR, May 20, 1988); Farm Finance: Financial Condition of American Agriculture as of December 31, 1987 (GAO/RCED-89-33BR, October 18, 1988); Agriculture Issues (GAO/OCG-89-12TR, November 1988).

[2] Financial Audit: Farmers Home Administration's Financial Statements for 1988 and 1987 (GAO/AFMD-90-37, January 25, 1990).

[3] This is when a loan is restructured to provide for a write-down of debt to the recovery value of the collateral where the return to the government under the restructured debt is at least as great as the return from involuntary liquidation.

Problems in the HUD and VA housing programs were similar. Specifically, in these agencies' housing programs, delinquencies, and terminations for default increased at greater rates than receivables and guaranteed loans. For example, VA's guaranteed loan terminations for default increased at almost 5 times the rate of its outstanding guaranteed loans, while HUD's terminations increased at more than triple the rate of its outstanding guaranteed loans. Housing loans at these agencies are particularly subject to risk due to economic conditions, such as recessions, unemployment, and changes in interest rates. A March 1989 President's Council on Integrity and Efficiency report[4] on guaranteed loans found that increases in HUD's Federal Housing Administration and VA housing defaults were a result of several factors, such as poor economic conditions and deficiencies in agency policy implementation.

In November 1989,[5] we testified that HUD's Federal Housing Administration's default and foreclosure rates were persistently high in economically stressed regions, particularly the Rocky Mountain and Southwest regions. Also, we projected that if house prices appreciate at least 6 percent per year and economic conditions remain generally favorable, the insurance fund for the Single Family Housing program will likely remain solvent. However, if house prices appreciate at less than 6 percent, the fund will be stressed, and if the rate is only 2 to 4 percent, the fund likely will not be able to survive without U.S. Treasury assistance. Similarly, our audit of VA's fiscal year 1988 financial statements[6] disclosed that VA's loan guaranty fund needed increased funding, primarily due to the weakened financial condition in the energy and agricultural sectors of the economy. From fiscal year 1980 through fiscal year 1988, VA's loan guaranty fund received about $3 billion in appropriations and transfers from other funds. Further, VA estimates that the fund will need an additional $1.34 billion in appropriations and transfers in fiscal years 1989 and 1990.

The Small Business Administration in the past 3 years experienced the most favorable changes of the five major credit agencies. SBA's loan delinquencies decreased more (23 percent) than its loans receivable (4 percent). Similarly, terminations for default decreased by 2 percent

[4]President's Council on Integrity and Efficiency: Coordinated Review of Guaranteed Loans, Segment II, Compilation of Significant Guaranteed Loan Issues Identified by Audits, Investigations, and Other Reviews (March 20, 1989).

[5]Impact of FHA Loan Policy Changes (GAO/T-RCED-90-17, November16, 1989).

[6]Financial Audit: Veterans Administration's Financial Statements for Fiscal Years 1988 and 1987 (GAO/AFMD-89-69, September 15, 1989).

while the agencies' outstanding guaranteed loans increased 11 percent. Thus, fewer loans are delinquent or in default status relative to the amount of receivables and outstanding guaranteed loans. Also, loans receivable write-offs increased a relatively modest 7 percent compared to the overall increase of 1,694 percent. Although SBA does have a high rate of delinquencies to loans receivable (24 percent in fiscal year 1988), this is due to the high risk nature of the loans which are primarily made to businesses unable to obtain private financing.

## Government's Loan Picture Worse Than Reported

Agencies have attempted for years, without success, to develop systems to solve their problems in accounting for receivables. Our accounting system and financial statement audits, as well as inspector general reviews, have consistently disclosed serious weaknesses in agencies' systems that account for and control receivables. Agency managers need accurate and reliable information to determine the value and collectibility of debts owed the government. The managers do not always get such information. For example, on their financial reports to Treasury, three agencies—FmHA, SBA, and HUD understated delinquencies because they did not follow Treasury reporting instructions. The government's loan portfolio is, therefore, in worse condition than indicated by some agencies' financial reports.

FmHA and SBA understated delinquencies because they did not report delinquent loans in accordance with Treasury instructions. For financial reporting purposes, Treasury requires agencies to report as delinquent the entire principal amount of loans which are over 180 days delinquent. Reporting these loans as delinquent is important to provide a realistic picture of the future collectibility of the agency's portfolio. For example, when classifying loan risk, OMB and Treasury consider a loan delinquent 120 days or more to be a loss. Contrary to Treasury requirements, FmHA and SBA report only those payments missed as delinquent on their financial reports, unless their field offices have formally required a borrower to remit the entire loan principal. We estimate that, because of this, FmHA's fiscal year 1988 delinquencies were understated by about $9.5 billion and SBA's were understated by $222 million. Both SBA and FmHA modified their reporting to comply with Treasury instructions as of June 30, 1989.

Treasury also requires that agencies show on their financial reports debts in litigation as delinquent. However, HUD understated delinquencies in its September 30, 1988, financial report to Treasury by $1.2 billion because it did not report such debts as delinquent. HUD disclosed this in a footnote, and OMB adjusted HUD's amounts to reflect the correct delinquency in its fiscal year 1990 report to the Congress on debt collection. In its June 30, 1989, report to Treasury, HUD accounted for debts in litigation as delinquent. Further, in the case of HUD, our financial audit of the Federal Housing Administration's financial statements showed that fiscal year 1988 losses were $4.2 billion,[7] which is almost five times its originally reported amount of $858 million.

Accurate and consistent data on credit programs is important so that the Congress, the administration, and federal agencies can make informed decisions on, and be able to properly control, the government's credit programs. As we stated in our 1986 report on debt collection,[8] due to accounting systems that are antiquated, error prone, and time-consuming to operate and reconcile, many agencies were unable to generate accurate and reliable accounting information on receivables. Although progress has been made in this area, we reported in November 1988[9] that agencies needed basic information to control and collect billions in accounts and loans receivable owed the government.

## Conclusions

Historically, the full magnitude of the government's credit picture has not been readily discernable because some agency financial reports did not fully disclose this worsening condition. Due to accounting system limitations and policy decisions, three agencies did not comply with Treasury's instructions in preparing credit activity financial reports. This has resulted in these agencies significantly understating delinquencies at the end of fiscal year 1988. Accurate, consistent, and meaningful data are essential if managers and policymakers, such as the Congress and OMB, who are responsible for overseeing governmentwide credit management and debt collection, are to make sound decisions about the government's credit programs.

Despite OMB's nine-point program and the increased emphasis on correcting the government's credit management problems by OMB, Treasury, and the federal agencies, the credit picture for the federal government

[7] 1988 Financial Audit: Federal Housing Administration (GAO/T-AFMD-89-17, September 27, 1989).

[8] Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

[9] Financial Management Issues (GAO/OCG-89-7TR, November 1988).

and for each of the major credit agencies, except SBA, continues to deteriorate. This deterioration is indicated by delinquencies and terminations for default increasing at a greater rate than loans receivable and guaranteed loans outstanding. Because of the nature of government loan programs, whereby loans are disbursed to or guaranteed for borrowers who cannot obtain private financing, the government's loan portfolio is inherently risky. While some of the worsening credit picture can be attributed to economic conditions in certain segments of the economy, some of the deterioration is the result of agencies' failure to fully implement the nine-point program, as discussed later in this report. The worsening credit picture at Agriculture, HUD, and VA is primarily attributed to the difficulties in the agriculture and energy sectors of the economy in the past decade. Education's deteriorating credit condition was primarily due to defaults from the large number of loans made in the late 1970s and early 1980s, relatively fewer federal dollars available for grant programs, increases in higher education costs, and a policy which has targeted Stafford loans to lower middle and lower income individuals. If these conditions continue or develop in other segments of the economy, the government's credit picture could further deteriorate. Also, deterioration of the government's credit picture compounds the budget deficit.

## Agency Comments and Our Evaluation

Treasury commented that management of guaranteed loans differs from that of direct loans. This is because the agency is not dealing directly with the borrower, but with and through private sector lenders who must be appropriately monitored. In addition, Treasury commented that defaulted guarantees will continue to increase until the government implements improvements in guaranteed loan management. To address this problem, a special task force is currently developing recommendations for improving guaranteed loan management, which will be presented to the Federal Credit Policy Working Group, a high-level working group of the Economic Policy Council responsible for reviewing major federal credit policy issues. We realize that, for the above reasons, agencies face different problems in managing guaranteed loans than they do with direct loans. Because of this and the huge number of guaranteed loans and the potential losses to the government associated with them, we fully support the administration's efforts to develop recommendations for better management of guaranteed loans.

Both OMB and Treasury believe there is a need for improved financial reporting systems which can produce accurate and timely credit management data. In particular, Treasury commented that having agencies improve their financial reporting systems and move toward accrual based financial statements is critical in order to quantify risk exposure and have "early warning" of potential financial disaster.

Treasury also commented that the changes in loans receivable information emphasized in our report indicate a deterioration in the agencies' portfolios and highlighted reasons, discussed in the report, for the decrease in loans receivable. Treasury also pointed out that improved agency reporting resulted in the government's financial situation appearing worse in the short run.

# Loan Origination Procedures Need Strengthening

The first phase of the credit cycle—loan origination—is critical because an agency's policies, standards, and procedures for extending credit have a direct affect on the future collectibility of debt and the ultimate cost to the government. Credit extension encompasses steps taken by agencies to ensure that loans are made to eligible applicants, the loan will be repaid, and the government's interests are protected.

Under its nine-point credit management program, OMB instructs federal agencies to screen applicants for federal direct or guaranteed loans for credit worthiness and financial responsibility and to determine if they owe delinquent debt to the federal government. OMB Circular A-129 and the Treasury Financial Manual credit supplement provide guidance for agencies to use in extending credit. While agencies are not legislatively required to follow Circular A-129 and the Treasury Financial Manual credit supplement, OMB and Treasury consider these documents to be statements of federal policy which federal agencies should follow unless specifically prohibited by legislation. In regard to loan origination, OMB and Treasury instruct agencies to (1) screen applicants to determine their credit worthiness, ability to repay, and delinquency on other federal debt, (2) include in loan forms a borrower's certification that he or she does not owe a delinquent federal debt, (3) withhold credit to applicants found to be delinquent on federal debts, (4) inform applicants of the federal government's collection policies and procedures for delinquent debts and require borrowers to sign a certification that such information was provided, and (5) assess loan origination fees to defray agency servicing and collection costs and as great a portion as possible of estimated loan losses.

Most agencies we reviewed had procedures which required the screening of loan applicants to determine eligibility, credit worthiness, and if the applicant owed a delinquent debt to the agency making the loan. However, most agencies did not (1) prescreen to determine if the applicant was delinquent on federal debts at other agencies, (2) require that credit be denied if an applicant owed a delinquent debt to another federal agency when denial would be consistent with program legislation, or (3) require borrowers to certify that they were informed of federal debt collection practices. Further, most agencies we reviewed did not charge loan origination fees that covered the government's cost of making the loan. This was primarily because of legislation which set the amount of or prevented the charging of such fees.

The importance of effective loan origination procedures was highlighted in a March 1989 President's Council on Integrity and Efficiency report on guaranteed loans.[1] The Council's analysis of over 5,000 audits, investigations, and reviews conducted by inspectors general and others over the past 3 years on the government's home mortgage programs showed that weaknesses in loan origination practices by guarantee lenders were the most common findings reported.

## Screening of Loan Applicants Could Be Improved

Except for Education, each of the agencies we reviewed generally required that credit bureau reports be obtained prior to extending loans. Also, except for FmHA's Single Family Housing loans, each of the agencies included in our review was generally screening applicants to determine if they owed delinquent debts to the agency making the loan. However, none of the agencies included in our review was routinely cross-checking with other federal agencies, including IRS, to determine if applicants owed past due federal debt. Agencies' automated system capabilities do not permit this type of prescreening.

OMB's Circular A-129 and the Treasury Financial Manual credit supplement set forth several mechanisms for screening loan applicants. These include

- using credit bureau reports to obtain applicants' past payment history;
- matching loan applicants with internal agency files to determine if an applicant owes delinquent debts to the agency making the loan; and
- matching applicants with IRS delinquent tax files to determine if an applicant owes delinquent taxes.

Credit bureau reports are used to verify applicant information, check for credit worthiness, and are a primary means for agencies to determine if an applicant has a delinquent federal debt with another agency. Education was the only agency we reviewed which did not require that credit bureau reports be used for screening loan applicants. This is because credit worthiness is not a criterion for receiving a Stafford or Perkins loan under the Higher Education Act of 1965, as amended.[2]

[1] President's Council on Integrity and Efficiency: Coordinated Review of Guaranteed Loans, Segment II, Compilation of Significant Guaranteed Loan Issues Identified by Audits, Investigations, and Other Reviews (March 20, 1989).

[2] Under the Stafford Student Loan program, state or private nonprofit guaranty agencies guarantee loans made by participating lenders to eligible borrowers. Under the Perkins Loan program, each participating school establishes and maintains a revolving loan fund from which the institution extends loans to eligible students. Each fund consists of federal and school funds.

However, because of increased emphasis on credit management, Education has in the past supported legislation that would make credit worthiness a criterion for loan applicants over 21 years of age. Specifically, for these applicants, Education has supported requiring credit bureau reports and cosigners for those with poor credit ratings. Education has pursued this approach because many of those applying for student loans are young and thus have not yet established a credit history. We support Education's position. Such an approach would be more practical than obtaining credit bureau reports on all applicants. Because loans are made by private lenders and insured by guaranty agencies, it is important that their input be obtained in establishing procedures for obtaining this information.

Concerning agencies' efforts to screen applicants in-house, HUD's system for doing this is automated and has features that could be effectively used by other agencies. In 1987, HUD implemented a system for screening applicants under its Single Family Housing program. Title I loans were added in 1988.[3] Lenders participating in these HUD programs are required to use this system to determine if applicants have previously defaulted on other HUD insured loans. HUD estimated that this system had resulted in the avoidance of $508 million in claims and $182 million in losses through the end of fiscal year 1988. Because of the success of HUD's new system, OMB and Treasury are taking steps to include other agencies' delinquent loans in the system and make information in the system available to these agencies and guarantee lenders participating in their programs. The objective in expanding this system is to give all participating agencies and lenders participating in their programs a means of prescreening a loan applicant's credit rating with the federal government. The first agency to be included will be the Department of Veterans Affairs because its loan programs are similar to HUD's.

We believe that an expanded CAIVRS will be a feasible and valuable screening mechanism for federal credit agencies. However, before this system can be expanded, several legal questions as to whether the Privacy Act permits agencies to share information envisioned under the expanded CAIVRS must be resolved. In April 1989, HUD requested OMB's opinion on the applicability of the Privacy Act to the expanded system. In January 1990, OMB responded that the Privacy Act does not bar HUD

[3]The Credit Alert Interactive Voice Response System (CAIVRS) allows authorized lenders to match, through telephone access, loan applicants against HUD's file of delinquent debtors. The system checks an applicant's social security number as entered by the lender against those on HUD's delinquent debtor file. The lender is then advised if a match has been made.

from expanding CAIVRS to become the governmentwide prescreening mechanism.

FmHA screening of Single Family Housing loan applicants to determine if they owe delinquent debts to FmHA could be improved. A March 1989 inspector general report found that 81 of 113 County Offices reviewed did not comply with FmHA procedures in approving loans for debtors with prior FmHA defaulted loans. Further, the inspector general reported that borrowers had received new loans after defaulting on prior FmHA loans. FmHA acquired, or is in the process of acquiring, property from 39 percent of these debtors. To address this problem, FmHA had implemented a system whereby field office staff could utilize a computer inquiry screen to check applicants for prior FmHA debts. However, County Supervisors are not required to use this system, and according to FmHA officials, most supervisors are not using it. In early 1990, FmHA plans to publish regulations requiring County Supervisors to use this system as part of its prescreening process. Further, this system does not identify certain critical information, such as loans which have been unsatisfactorily settled. A modification to identify unsatisfactorily settled debt was deferred so resources could be redirected to implement farm program legislation. This is currently scheduled for implementation during May 1991.

Although the agencies in our review, except FmHA, screen applicants internally for delinquent debt, none check with other federal agencies. OMB's and Treasury's goal to include other federal agencies in HUD's internal screening system is an attempt to overcome automated system limitations which prevent agencies from checking with other federal agencies to determine if an applicant owes a delinquent federal debt. This is especially important since a study by SBA indicated that credit bureau reports, currently a primary source for federal agency delinquent debt information, only showed known delinquent federal debt information less than 25 percent of the time.

Another potentially useful screening tool is to match loan applicants against IRS' delinquent tax files because (1) there is a large number (approximately 18.5 million) of delinquent taxpayer accounts and (2) IRS delinquencies are not reported to credit bureaus. However, no agency matched loan applicants against IRS delinquent tax files. The Debt Collection Act of 1982 specifically provides this authority to federal agencies.

In 1986, we reported that this tool was not being used and at that time was not practical primarily because of IRS' long response time. Since then, little progress has been made toward developing this tool into a viable credit management screening option. Agencies are still not using this tool because of IRS' inability to provide this information promptly. IRS' response time ranges between 1 and 2 months, which according to officials at three of the five major federal credit agencies, is too long for their loan approval processes. Also, an IRS official informed us that agencies are not anxious to use this tool because of the stringent security requirements for protecting tax data.

As an alternative to the current IRS screening procedures, guarantee lenders as well as federal agencies have another option for obtaining tax information. Under 26 U.S.C. section 6103(c) of the Internal Revenue Code, if the applicant consents, tax information can be obtained from IRS. According to an official in IRS' Office of Disclosure, information obtained under this section of the code is not subject to the same security requirements as that obtained without the loan applicant's consent. An IRS official informed us that this is often used by lenders when processing private sector loans but he could not estimate how long it took private lenders to obtain this information under section 6103(c). We believe that screening loan applicants against IRS delinquent tax accounts would provide agencies with valuable information to use in making loan decisions.

## Some Applicants Not Required to Certify They Do Not Owe Delinquent Federal Debts

Another means to help ensure that agencies do not knowingly extend credit to applicants who owe delinquent federal debts is to have the borrower certify that he or she is not delinquent on other federal debts. OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct federal agencies to modify credit application forms to include a statement as to the applicant's status on federal tax and nontax debts.

HUD's Single Family Housing and Title I programs, SBA, and VA require loan applicants to certify that they are not delinquent on other federal debts. In addition, HUD and FmHA require participants on Multifamily Housing loans to certify that no mortgage on a project in which they have been involved has ever been in default, assigned to the government, or foreclosed. However, Education and FmHA for its Single Family Housing program do not require applicants to certify that they are not delinquent on a federal debt. According to an Education official, such a certification is not required because it is not part of the eligibility requirements for receiving a student loan. However, a May 1988 opinion from Education's Office of General Counsel concluded that Education can (1) require applicants to certify that they are current on federal financial obligations and (2) direct guarantee lenders to consider whether a delinquent debt owed to the federal government demonstrates a lack of credit worthiness. FmHA maintains that its current loan application for the Single Family Housing program, which requires all debts to be listed and warns that false statements could result in fines or imprisonment, is sufficient. However, FmHA plans to include such a certification the next time its application is revised.

To require a certification regarding delinquencies on other federal debts would impress upon the borrower the importance of repaying government loans. In addition, Circular A-129 provides agencies with an optional sample certification statement. Adopting this statement would require minimal effort on the part of the agencies or the borrower and, in our opinion, would help the agency assess the applicant's ability and willingness to repay.

## Some Applicants Who Owe Delinquent Federal Debts Not Denied Credit

OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct federal agencies to suspend processing of applications for federal direct or guaranteed loans when applicants are found to be delinquent on a federal debt. Processing is not to be continued until the debt is paid in full or satisfactory repayment arrangements are made. SBA and HUD procedures generally require that credit be denied to applicants delinquent on federal debts, until the delinquency is resolved. However, FmHA Rural Housing loan procedures, Education procedures, and VA procedures do not prohibit making or guaranteeing loans to applicants who have delinquent federal debts.

Agencies we reviewed have various reasons for their policies. According to FmHA officials, the County Supervisor decides whether to extend Single Family Housing credit to an applicant who owes a delinquent federal debt. County Supervisors are required to deny credit to applicants with unsatisfactorily settled FmHA debts; however, FmHA's Single Family Housing regulations do not address other federal debts. Also, FmHA's Multifamily Housing regulations do not require that credit be denied based on delinquent federal debts. Education believes it does not have legislative authority to deny credit based solely on delinquent accounts an applicant may have with another federal agency. According to VA officials, even though not specifically stated in its regulations, it is VA's policy not to make or guarantee a loan to applicants who owe delinquent federal debts. The decision to make a loan to a delinquent federal debtor is made by the regional office after considering whether or not the delinquent debtor has arranged a satisfactory repayment schedule. In commenting on our report, VA stated that it would revise its instructions to deny credit to applicants who are delinquent on federal debts.

We recognize that in some instances, such as Education loans, legislation may not allow agencies to deny loans to applicants who already owe delinquent federal debts. However, we believe that, agencies, where allowed by program legislation, could improve the probability of collecting loans if they denied loans to applicants who are found to be delinquent on any federal debts.

## Some Applicants Not Required to Sign Certification of Knowledge of Debt Collection Practices

To ensure that borrowers understand actions the federal government may take in the event of default and to impress upon the borrowers the consequences of not repaying loans, Circular A-129 and the Treasury Financial Manual credit supplement instruct agencies and lenders to have borrowers sign a certification which details the government's delinquent debt collection policies and procedures. SBA, VA, FmHA, and HUD's Single and Multifamily Housing programs require borrowers to sign such a certification. While the other agencies included in our review maintain that they verbally or otherwise inform borrowers of these policies and procedures, borrowers under HUD's Title I program and Education's Stafford and Perkins loan programs are not required to sign a certification that they have been fully advised of the government's debt collection policies and procedures.

HUD requires lenders participating in the Title I program to provide a written notice to borrowers of HUD's role in collecting delinquent Title I loans. However, the notice does not include all actions that the federal government can take in collecting the debt, and the borrower is not required to sign the notice. HUD plans to require such a signature in the future, but because this will require a regulatory change, the department has not established a target date for its implementation.

In addition, Education does not require borrowers to certify that they have been fully advised of the government's debt collection policies and procedures. Education officials advised that they do not require such a certification because they believe that current written disclosures provided by lenders are adequate. However, these disclosures do not specifically list each of the actions that the federal government can take in the event of default. Further, in 1988, we reported that an option for reducing potential defaults in Education's Stafford Loan program would be to require borrowers to sign such a certification.[4] This is especially applicable to loan applicants who are relatively young and may be first-time borrowers.

Although borrowers can be informed of these procedures without signing such a certification, requiring this certification would better impress upon the borrower the importance of repaying a federal debt.

## More Realistic Loan Origination Fees Needed

Chapter 2 discussed changes in loans receivable information which indicate that the government's credit picture continued to deteriorate between fiscal years 1985 and 1988. One way of helping to reduce the government's losses is to charge loan origination fees. OMB Circular A-129 instructs agencies to assess loan origination fees on direct and guaranteed loans in order to defray servicing and collection costs and to cover as great a portion as possible of the estimated loan losses. However, in some instances agencies we reviewed do not charge fees, usually because of legislative requirements, and most fees charged generally do not compensate the government for the costs it bears when borrowers default. Several agencies have recognized this, but proposals to increase fees have generally been rejected by the Congress.

Loan origination fees are not assessed on FmHA's Multifamily Housing loans because of legislation which prohibits such fees. SBA's fiscal year 1989 and 1990 appropriation acts prohibit SBA from establishing new loan fees. Prior to 1989, SBA did not charge loan origination fees for its Disaster Loan program because it believed such a fee would be contrary to the program's purposes. An official in SBA's Disaster Assistance Division explained that because these loans are made with subsidized funds to help disaster victims, SBA believes that loan origination fees are inappropriate. In addition, fees are not assessed on FmHA's Single Family Housing loans. FmHA plans to draft procedures to assess a $75 loan origination fee on Single Family Housing loans, but no implementation date has been set.

While Education charges a legislatively set 5 percent origination fee on Stafford loans, it is not authorized to charge such fees under the Parent Loans to Undergraduate Students and Supplementary Loans for Students programs. Education officials stated that these loans are not subsidized as much as Stafford loans, and Education, therefore, does not

[4] Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, January 7, 1988).

need the fees to offset program costs. However, Education guarantees lenders a minimum rate of return based on the Treasury bill rate. In addition, over the past several years, the loan volume and defaults under these programs have substantially increased. In our 1988 report on potential default and cost reduction options (see footnote 4), we presented the charging of loan origination fees for these programs as an option for reducing the federal costs involved in administering the Stafford Loan program. Proposed legislation[5] would establish a 5-percent loan origination fee for both the Parent Loans to Undergraduate Students and Supplementary Loans for Students programs.

Both SBA, for its business loans, and VA charge legislatively set loan origination fees. The SBA fee is set at two percent of the loan amount. However, the Congress has rejected proposals to increase this fee which is insufficient to defray administrative costs and estimated loan losses. The Veterans' Benefits Amendments of 1989 (Public Law 101-237, effective January 1, 1990) gave VA authority to generally charge a fee of 1.25 percent of the total loan amount.

HUD charges insurance premiums which vary by program. In May 1989, we reported[6] that the insurance fund for the Single Family Housing program is in sound financial condition despite significant losses in geographic areas experiencing economic problems. However, charges under the Title I Manufactured Home Loan program have not been sufficient to offset claim losses and, in October 1989, HUD revised its method of collecting premiums on these loans in order to correct this problem. Most of the premium charge is now collected during the early years of the loan when the risk of default and claim losses are greatest. While premiums for the fund which insures Multifamily Housing loans have generally not been sufficient to cover costs, HUD has not increased the premiums because, according to HUD officials, the program is not intended to be self-sufficient.

We realize that due to the nature of government loan programs, fees may not cover all costs. However, loan origination fees can be used to help defray agency administrative costs and estimated loan losses. This would be especially beneficial to the government during a period where it is facing a huge deficit. Periodic reviews of the adequacy of agency

[5]The Stafford Student Loan Default Prevention and Management Act of 1989, S. 568, was introduced March 15, 1989, and passed the Senate on March 17, 1989.

[6]Financial Management: Federal Housing Administration's Accounting Methods and Section 203(b) Program (GAO/AFMD-89-26BR, May 5, 1989).

loan origination fees could support fee adjustment proposals to the Congress. This would help ensure that such fees cover, to the extent feasible, administrative costs and loan losses while not adversely affecting program goals.

## Conclusions

Although the five agencies we reviewed progressed in implementing the nine-point program initiatives addressing loan origination, they have not adequately utilized some significant loan origination tools. In particular, one agency was not effectively screening loan applicants to determine if they owed delinquent debts to the agency making the loan; two agencies did not require applicants to certify that they did not owe delinquent debts to the federal government; three agencies' procedures did not specifically require that credit be denied to applicants who owed delinquent debts to the federal government; and two agencies did not require borrowers to certify that they were aware of the government's debt collection policies and procedures. Because loan origination is a critical phase of the credit management cycle, it is important that agencies use all available credit management tools when extending credit. Together these tools provide agencies with a solid framework for protecting the government's interests by helping to ensure the future collectibility of loans.

An example of an effective loan origination tool is the HUD in-house screening system which we believe may be a potentially viable system for governmentwide screening for nontax delinquent debt. However, a system is not available which would effectively and promptly screen loan applicants against IRS' delinquent tax files. Because of the large number of delinquent tax accounts, we believe the government's ability and effectiveness in screening loan applicants could be greatly improved by resolving impediments preventing the matching of loan applicants against IRS' delinquent tax accounts. Matching loan applicants against these accounts would not only provide agencies with information to be used in the loan making decision, but could also help encourage delinquent taxpayers to bring their accounts up to date by informing them that additional credit will not be extended until the tax delinquency is resolved.

Also, loan origination fees charged by agencies we reviewed are generally not sufficient to cover administrative costs and estimated loan losses. In some cases, these fees are not intended to cover these costs. Further, in some instances, fees were not charged. Although we realize that it may be unrealistic to expect loan origination fees to cover all costs associated with government lending programs, we believe that the government's credit management could be improved if agencies charged fees for all programs where legislatively allowed.

## Recommendations to Agencies

To improve loan origination procedures, we recommend that the Director of the Office of Management and Budget and the Secretary of the Treasury, in conjunction with the Internal Revenue Service and affected agencies, resolve impediments to prescreening loan applicants against delinquent tax accounts.

We also recommend that

- the Secretary of the Department of Education and the Administrator of the Farmers Home Administration require program managers or private lenders to modify loan applications to include an applicant's certification that he or she is not delinquent on federal debt;
- the Secretary of the Department of Veterans Affairs—for VA's Loan Guaranty program—and the Administrator of Farmers Home Administration—for FmHA's Rural Housing programs—require program managers to deny credit to any loan applicant found to be delinquent on a federal debt, until the debt is satisfactorily resolved;
- the Secretaries of the Departments of Education and Housing and Urban Development require that program managers and private lenders modify loan applications to include a signed borrower's certification that the borrower has been advised of and understands the government's debt collection practices.

## Agency Comments and Our Evaluation

OMB commented that (1) effective loan origination is critical to preventing future losses, (2) there is a need for more agency compliance with prescreening requirements, (3) federal assistance should generally be denied to applicants who owe delinquent federal debts, and (4) loan origination fees should cover servicing and collection costs. Treasury believes that continued implementation of the nine-point program is essential if long-term permanent changes are to be made in the federal government's financial management practices. We agree with Treasury's assessment, and our report emphasizes this major point.

VA agreed to revise existing instructions to deny credit to applicants who have outstanding federal debts unless they provide evidence that the debts have been paid in full or a repayment plan is established.

Education partially agreed with our recommendation that loan applications be modified to include applicants' certifications that they are not delinquent on federal debt. Education commented that it will conduct some analysis to determine the effectiveness of implementing this proposal, but stated that it is concerned about the burden this would impose on the total student loan population. In our opinion, the additional burden imposed by asking loan applicants to sign statements that they are or are not delinquent on a federal debt would be minimal.

HUD agreed with our draft report recommendation to obtain tax data from IRS. SBA commented that it could require applicants to consent to its obtaining tax data, but that the processes for obtaining such information from IRS must be implemented to allow loan applications to be processed promptly. VA stated that it would explore this option. In addition, OMB commented that agencies should begin cross-checking against IRS delinquent tax files and stated that it is working with IRS on a prototype match to identify and resolve specific operational problems and quantify benefits, including the use of taxpayer consent forms.

IRS, however, opposed the use of taxpayer consents to obtain tax information in this manner. IRS expressed its concern over the impact that disclosing tax information can have on taxpayers' confidence in the tax system and discussed several criteria it believes should be met before such disclosures are made. It also expressed its belief that it is unlikely that this information can be obtained more quickly with taxpayer consent than under the current procedures. In addition, it discussed its concern about the added burden this would impose on IRS. It said that agencies receiving tax information pursuant to a taxpayer consent are not required to safeguard the information and that they are not subject to penalties for unauthorized disclosure. IRS added that agencies should be strongly committed to safeguarding this information. Further, it raised legal concerns associated with this procedure. On this latter point, in Tierney v. Schweiker, 718 F. 2d 449 (D.C. Cir. 1983), the court struck down the notice-and-consent form used by the Social Security Administration in administering the Supplemental Security Income benefit program because (1) it did not meet IRS' procedural requirements and (2) it did not provide for knowing and voluntary consent.

We realize that the procedures we are proposing raise privacy and confidentiality issues. However, the fact remains that IRS has a wealth of information that we believe should be used by federal agencies and lenders participating in their loan programs in making loans. Also, as pointed out in this report, the government's credit situation continues to deteriorate, and the risk to the government from its credit programs continues to grow. We believe that one means of helping to reduce this risk is to screen applicants against delinquent tax accounts. Further, the mechanism established in response to the Debt Collection Act of 1982 for federal agencies to obtain this information is not working because it does not provide federal agencies with this information promptly. Also, lenders of guaranteed loans originated in the private sector are denied access to IRS data. Utilization of the consent we are proposing would provide additional information for private sector lenders to use in making loan decisions. Moreover, the Tierney court recognized the possibility for the legal use of consent forms. In this regard, the court stated that "we intimate no views on whether another form—one which contains no veiled threats and sets forth the substantive and procedural rights of Benefits recipients—could result in knowing and voluntary consent." Federal agencies and lenders would, of course, need to be mindful of the procedures set forth in Tierney.

In commenting on this issue, IRS stated that it would be willing to work with federal agencies to obtain this information as quickly as possible using currently available systems. This is in conformance with our recommendation that IRS, OMB, Treasury, and affected agencies resolve the impediments which prevent the current system from providing agencies with such information promptly. The key point in this issue is that federal agencies and their lenders be able to obtain this information promptly.

Even though IRS is willing to work with federal agencies to provide this information more expeditiously, developing the mechanism for doing this on a governmentwide basis will take some time. Agencies are making direct loans and private lenders are continuing to make government guaranteed loans without the benefit of cross-checking with IRS to determine if the applicant owes a delinquent tax account. Because of IRS' concerns, we are modifying our original recommendation that certain agencies use the consent form for obtaining tax information to be used in the loan origination process and are now recommending that the Congress require that the consent form be utilized on a test basis to evaluate its effectiveness. (See chapter 6.) Such a test has been used to determine the effectiveness of the tax refund offset program and the use of private sector attorneys to collect delinquent federal debts.

HUD agreed with our recommendation that loan applications be modified to include a borrower's signed certification that he or she has been advised of and understands the Government's debt collection practices.

The Department also agreed to modify those applications that do not require this. Agriculture responded that FmHA published regulations requiring borrowers to sign a certification statement that they have been advised of and understand the government's debt collection practices. While Education disagreed with our recommendation that loan applications be modified to include a signed borrower's certification that the borrower has been advised of and understands the government's debt collection practices, it is implementing procedures which partially comply with the recommendation, namely drafting regulations which require further disclosures to the borrower. However, it is not clear whether Education will require the borrower to sign a certification acknowledging that he or she has been advised of and understands these collection practices. As we point out in the report, requiring signed certifications would better impress upon the borrower the importance of repaying a federal debt.

# Account Servicing Needs Continued Emphasis

After credit is extended, agencies must service accounts in a manner that best protects the government's investment. Servicing encompasses those actions required to maintain accounts in current status. OMB's nine-point credit management program instructs agencies to use modern business techniques and automation to establish proper maintenance of files and proper review and management of accounts. The nine-point credit management program also directs agencies to sell loan assets to the public without recourse.[1] OMB Circular A-129 sets forth several servicing standards for federal agencies such as routine billing and up-to-date loan file documentation reflecting accurate payment histories. In addition, OMB Circular A-129 states that agencies should require lenders of federally guaranteed loans to maintain loan servicing documentation consistent with the circular.

Agencies' progress in improving servicing of loan accounts varied. Three of the agencies we reviewed had particular success in lowering delinquencies by consolidating servicing and collection activities at regional centers. Also, four of the programs conducted loan asset sales or allowed prepayments during fiscal years 1987 and 1988, which served to reduce government servicing actions by transferring them to the private sector. On the other hand, several of the agencies were not adequately monitoring private sector servicing of guaranteed loans. In addition, FmHA's servicing was hampered by inadequate automated systems.

## Servicing and Collection Activities Consolidated

HUD, SBA, and Education each consolidated routine servicing and collection activities into regional centers for their Title I, Disaster, and Perkins and Stafford Loan programs, respectively. According to these agencies, consolidation resulted in increased loan servicing efficiencies. For example, HUD's consolidation of 13 offices into one regional servicing and collection center resulted in a 70 percent increase in collections as well as reductions in staff years, travel costs, and write-offs. SBA and Education also attributed improved credit management, such as increased collections and reduced staff hours, to the consolidation of operations. We did not verify the efficiencies reported by HUD, SBA, and Education.

FmHA, which has over 1,900 County Offices, has not pursued efforts to consolidate servicing and collection activities into regional centers. However, with OMB's encouragement, FmHA has agreed to study the feasibility

[1] When a loan is sold without recourse, the federal government does not guarantee future payments of interest and/or principal on the loan to the purchaser.

of separating staff responsibilities between loan origination and servicing functions at the County Offices. This is because OMB is concerned about the internal control implications of FmHA's current organizational structure in which the same individual can be responsible for approving, servicing, and collecting loans. One option for doing this could be to remove the routine servicing and collection activities from the County Offices and consolidating them into regional centers. Because of successes reported by SBA, HUD, and Education and the large number of FmHA field offices, FmHA could use this study as a vehicle to assess the feasibility of consolidating servicing and collection actions.

## Agencies Conducted Loan Asset Sales/ Prepayments

One of the nine-point credit management program initiatives is for agencies to sell loan assets to the public without recourse. In January 1986, the administration initiated a pilot sale of selected federal loan assets as part of the President's fiscal year 1987 budget request. The goal of the pilot sale was federal credit reform and financial management improvements with an ancillary goal of generating budget receipts. OMB expects administrative savings from selling loan assets without recourse because the sales would transfer servicing and collection activities to the private sector. Under the pilot loan sale program, the administration also offered borrowers the opportunity to prepay their loans. The administration plans to continue its sale of loan assets where this proves cost-effective for the government.

Over the past several years, we have reported on various facets of the government's loan asset sales.[2] Our reports focused on requirements in OMB's loan asset sale guidelines that would have had a major impact on the marketability of the loans and the ability to maximize net sale proceeds. In addition, we disclosed that the total amount of principal and interest payments forgone by selling a loan is generally worth more than the revenue derived from the sale, that loan sales are likely to have some positive impact—albeit difficult to quantify—on credit management, and the loan asset sales will not resolve our fundamental deficit problem.

OMB Circular A-129 requires federal agencies to set forth loan asset sale plans in their annual budget submissions to OMB which explain sale

[2]Loan Asset Sales: OMB Policies Will Result in Program Objectives Not Being Fully Achieved (GAO/AFMD-86-79, September 25, 1986); Loan Asset Sales: An Assessment of Selected Sales (GAO/AFMD-88-24, February 19, 1988); Federal Assets: Information on Completed and Proposed Sales (GAO/RCED-88-214FS, September 21, 1988); Borrower Loan Prepayments: OMB Guidelines Need To Be Strengthened (GAO/AFMD-89-19, January 11, 1989).

plans and expected improvements to be realized. During fiscal years 1987 and 1988, FmHA, HUD, SBA, and VA conducted loan asset sales and/or prepayments in the programs we reviewed. For these programs, in fiscal years 1987 and 1988, loans valued at $4.8 billion were sold or prepaid for $3.3 billion. Generally these sales resulted in the transfer of servicing responsibilities to the private sector. Education did not sell any of its student loans because of anticipated low returns (estimated at up to 2 cents per dollar). In fiscal years 1989 and 1990, SBA has been legislatively prohibited from conducting loan asset sales.

## Some Agencies' Monitoring of Lenders and Guaranty Agencies Is Inadequate

The federal government's emphasis on guaranteed rather than direct loan programs has increased the importance of establishing and implementing effective lender monitoring procedures. OMB Circular A-129 and the Treasury Financial Manual credit supplement instruct federal agencies to monitor lenders to ensure that they meet the same loan servicing standards required of direct loan programs. However, neither document provides specific guidance to the agencies as to how to accomplish this requirement. Further, the March 1989 President's Council on Integrity and Efficiency report concluded that agencies need to improve their controls over lenders and to require that lenders (1) fulfill their loan processing, servicing, and supervision responsibilities and (2) file accurate and prompt claims for loan losses. While agencies generally have procedures to monitor lenders, including guaranty agencies, we believe that Education, SBA, and VA could improve their lender monitoring. We have previously reported on problems in HUD's lender monitoring in its Single Family Housing program.[3] However, we did not perform a detailed analysis of HUD's monitoring because of an ongoing GAO review on this specific issue. In addition, we did not review FmHA's lender monitoring practices because the Rural Housing program has very few guaranteed loans.

Agencies have not been given specific guidance on monitoring lenders. While OMB Circular A-129 instructs agencies to establish lender performance goals and to monitor lender actions, it does not cite specific methods for doing so. Similarly, the Treasury Financial Manual credit supplement states that agencies should ensure that lenders exercise due

[3] Stronger Internal Controls Over HUD Single-Family Mortgage Insurance Programs Would Discourage Fraud (GAO/RCED-85-4, May 13, 1985); Housing Programs: Agency Actions To Discourage Single Family Mortgage Insurance Fraud (GAO/RCED-86-172BR, June 3, 1986); Internal Controls: Weaknesses in HUD's Single Family Housing Appraisal Program (GAO/RCED-87-165, September 30, 1987).

diligence[4] in servicing direct loans; however, guidelines for doing so are not provided. Treasury is currently studying guaranteed loan programs and will address the need for lender performance and monitoring guidelines. This project is expected to be completed in early 1990.

Guaranteed loans insured by Education have risen sharply over the past several years—from $35.8 billion as of September 30, 1985, to approximately $47.6 billion at the end of fiscal year 1988. However, Education has reduced its monitoring of lenders and has not met its guaranty agency monitoring goals. Guaranty agencies are responsible for administering the Stafford Student Loan program within their respective states, encouraging participation by lenders and verifying that lenders use due diligence to collect on all claims filed under the guarantee provisions. In November 1986, Education issued regulations requiring guaranty agencies to follow specific due diligence procedures in collecting defaulted loans. As part of its monitoring activities, Education conducts on-site reviews of lenders, guaranty agencies, and schools. In a January 1988 report,[5] we reported that Education's on-site reviews of lender activities had decreased steadily—from over 800 lender reviews in fiscal year 1981 to fewer than 200 such reviews in fiscal year 1987. Education officials told us that the agency increased its monitoring to 325 lender reviews during fiscal year 1988 and that the reduction from 1981 was due to a lack of staff and other resources. In commenting on a draft of this report, Education stated that it completed 519 lender reviews in fiscal year 1989 and that guaranty agencies conducted about 700 lender reviews during fiscal years 1988 and 1989.

In addition to monitoring lenders, Education monitors the activities of the guaranty agencies because of their important responsibilities just outlined. While Education has a goal of reviewing each guaranty agency at least every other year, it reviewed 10 guaranty agencies in fiscal year 1988 and 13 guaranty agencies during fiscal year 1989. This represents about 48 percent of its goal. Education, however, plans to increase its guaranty agency reviews to 24 in fiscal year 1990. The importance of closely monitoring guaranty agencies is evidenced by an April 1988 Education inspector general report which detailed inadequate recordkeeping and documentation at some of these agencies. According to the Treasury

[4]Due diligence is defined as practices at least as extensive and forceful as those generally practiced by financial institutions.

[5]Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, January 7, 1988).

Financial Manual credit supplement, adequate documentation provides the foundation for all servicing and collection activities.

We believe that regular site visits are an effective method of monitoring guarantee lenders as well as guaranty agencies to ensure compliance with Education's requirements. In order to allow Education to perform more on-site reviews, Congress passed legislation which allowed Education to increase its staff by 90 positions to conduct reviews of lenders, guaranty agencies, and schools during fiscal year 1989.

According to OMB, because SBA's credit programs are moving from direct to guaranteed loans, the agency needs to direct its future credit management efforts towards ensuring that lenders follow OMB Circular A-129 prescreening and servicing provisions. As part of its efforts to monitor lenders, SBA procedures require their field offices to make annual visits to lenders with more than three outstanding loans. These visits are to include a review of at least 10 percent of each lender's SBA guaranteed loan portfolio. However, an SBA fiscal year 1988 review of internal controls at the field offices found that 21 of the 67 offices reviewed did not comply with SBA's procedures. SBA assesses the risk of adverse impact of not performing lender visits as high. According to SBA officials, the agency does not have sufficient staff to visit lenders regularly. In addition, SBA's fiscal year 1988 Federal Managers' Financial Integrity Act report identified field office staffing inadequacies as a material weakness. We believe that SBA's credit management program could be improved if SBA performed annual on-site lender visits.

Although VA guarantees loans made by thousands of lenders, it has no formal written agreements with these institutions. Further, the other guarantee programs in our review require formal, written, lender agreements. OMB believes that lender agreements are necessary and established a fiscal year 1989 goal for VA of developing a standardized loan contract for guarantee lenders and assessing penalties for lenders that fail to service loans in accordance with the contract. VA maintains that formal agreements with lenders are not necessary because its current lender certifications on their loan documents are sufficient. However, these certifications only list prescreening requirements, not servicing or collection policies and procedures that lenders must follow. In our opinion, formal written agreements protect the government's interest by requiring participating lenders to comply with specific servicing requirements. Such agreements could also prescribe specific penalties for lenders who do not meet government servicing standards.

In addition to the above, a March 1989 VA inspector general report stated that VA's Regional Offices were not enforcing lender servicing requirements. The review found that VA was not applying available limitations or sanctions to improve lender compliance with VA requirements. For example, in the case of poor lender performance, VA can reduce or refuse to pay lender claim costs; however, VA did not reduce claim costs in any of the Inspector General's sample cases although evidence of poor performance was found. In addition, the Inspector General found that VA Regional Office officials did not effectively monitor or control lender actions in about 72 percent of the cases reviewed.

## Automated System Problems Hinder FmHA Servicing

OMB Circular A-129 requires agencies to (1) ensure that efficient mechanisms are in place to collect and record payments and (2) provide support for servicing activities. Effective automation is essential to properly manage large loan portfolios because manually updating and retrieving accurate account data can hinder credit management effectiveness. Although each of the major credit agencies we reviewed had problems with automated systems, we found that FmHA's automated system problems were a major impediment to progress in the credit management area. Long-standing automated systems problems, such as the systems' inability to generate accurate and up-to-date account information, necessitate FmHA's reliance on extensive manual operations and are a major cause of the agency not fully implementing the prescreening, servicing, and collection provisions of the nine-point credit management program and OMB Circular A-129. Weaknesses in FmHA's servicing caused by system problems are addressed in the remainder of this section. Examples of FmHA prescreening and collection activities that are impaired by automated system problems are further discussed in chapters 3 and 5, respectively.

Since 1982, the Agriculture Inspector General has issued several reports detailing problems with FmHA's automated systems, such as untimely and inaccurate data on loan transactions and delinquencies, incorrect charging of interest on loans, and an inability of systems to generate management information on collection activity. In addition, Agriculture's fiscal year 1989 Federal Managers' Financial Integrity Act report identifies several material weaknesses in the Rural Housing program, which either relate to automated system problems or a lack of automated capabilities. For example, the fiscal year 1989 report states that the Rural Housing "existing accounting system does not serve the Agency's needs in respect to fundamental accounting and financial control functions."

FmHA recognizes the loan servicing limitations of its current system. For example, an FmHA issue paper discussing the feasibility of an automated collection system pointed out that field offices' ability to contact borrowers promptly has been hampered because of the lack of automation and the present system of distributing delinquency reports 30 days after payments are due. According to the Treasury Financial Manual credit supplement, rapid and aggressive action on delinquent accounts is critical for successful debt collection. Also, due to system constraints, there are time lags between when a payment is received and when it is posted to the borrower's account. This time lag, up to 8 days for Single Family Housing borrowers, restricts FmHA's implementation of credit management initiatives because the account balances might not reflect actual, up-to-date information. For example, due to this time lag, FmHA requires its field offices to verify the status of accounts to be sent to credit bureaus because the agency cannot rely on the accuracy and completeness of its account data. Also, FmHA field offices must verify the account status (such as whether an account has a pending bankruptcy) of all accounts sent for IRS tax refund or federal employee salary offset because the automated system may not be up-to-date. FmHA implemented this verification procedure in 1987 in order to reduce the number of borrower complaints and erroneous offsets. FmHA is attempting to alleviate some of these problems through various automation projects. However, an August 1988 Agriculture inspector general report detailed a lack of progress due to the lack of effective and efficient software and training. In addition, in a July 1989 letter to FmHA, OMB expressed concern about FmHA's automation because the agency has spent millions of dollars and considerable staff time on systems that are now obsolete and inadequate to handle loan servicing functions. Currently, FmHA is planning to redesign, replace, or enhance its automated systems at an estimated cost of at least $100 million over the next 5 to 7 years.

## Conclusions

OMB's Circular A-129 and the Treasury Financial Manual credit supplement set forth sound guidance which agencies' can use to implement the nine-point credit management program initiatives related to account servicing. While the agencies we reviewed had progressed in improving account servicing, several had not effectively utilized certain account servicing techniques which are basic to effectively implementing OMB's nine-point credit management program. Specifically, three agencies are not monitoring lenders or guaranty agencies sufficiently to ensure their compliance with OMB Circular A-129.

Several of the agencies in our review reported increased loan servicing and collection efficiencies as a result of consolidating these activities at a few sites. In our opinion, the consolidation of servicing and collection activities is a potential means of effectively utilizing agency credit management resources, especially for those agencies which have a large number of field locations.

Automated systems are essential to effectively service loan portfolios that have a large number of accounts. However, because of long-standing system problems, FmHA's account servicing activities have been hampered. Although FmHA recognizes this problem, its progress in correcting it has been slow.

## Recommendations to Agencies

To improve servicing activities, we recommend that the Administrator of the Farmers Home Administration address the feasibility of consolidating servicing and/or collection activities into regional centers. This should be part of FmHA's planned review of its County Office organizational structure.

To improve lender monitoring, we recommend that the Secretary of the Department of Education and the Administrator of the Small Business Administration require program managers to implement the procedures set forth in their agencies' regulations, such as regularly scheduled site visits. We also recommend that the Secretary of the Department of Veterans Affairs require program managers to develop and use formal lender agreements which include specific lender requirements and penalties for not achieving these requirements.

## Agency Comments and Our Evaluation

OMB strongly supported the report's conclusion that more needs to be done to improve loan servicing through upgraded financial systems and other improvements, such as consolidation of servicing centers. It also agreed with the need for strong management controls for guaranteed loans, including guidelines for lender performance and monitoring.

Treasury agreed that agencies need to fully implement appropriate credit management tools and monitor their lenders. However, it pointed out that credit management often competes with program operations for scarce resources. While we recognize that agencies have many competing priorities and limited resources, we believe that the magnitude of the government's credit management problem, in particular the potential losses that could result from the increasing shift to guaranteed instead of direct loans, dictates that credit management and program operations complement instead of compete with each other.

OMB agreed that, to protect the government's interests, formal written agreements should be required from lenders receiving federal guarantees. VA, however, commented that it is not necessary to incorporate lender agreements into the loan guaranty program because of the certifications lenders must make on the various forms VA requires and because VA can adjust or deny a claim based on a breach of these certifications. However, as we point out in this report, these certifications only list prescreening requirements and do not address servicing and collection policies and procedures lenders must follow. Also, VA's Inspector General found that the agency was not applying available sanctions to improve lender compliance because of a lack of specific lender servicing requirements in VA's regulations. We believe lender agreements would be a valuable mechanism for specifying lender requirements and for holding lenders accountable. Since VA guarantees such a large number of loans (in fiscal year 1988, VA guaranteed 234,709 loans valued at $17.3 billion), we believe that the added legal weight of signed agreements between VA and the lenders specifying responsibilities, rights, and sanctions will further protect the government's financial interest.

Agriculture commented that it believed our section on FmHA's automated systems did not accurately and fairly present all pertinent facts. Agriculture stated that significant improvements have been made in modernizing its automated systems and cited specific examples such as the installation, in the field offices, of multifunction workstations. Our report is not intended to be an overall analysis of FmHA's automated systems but includes a section on FmHA's systems as they pertain to the agency's implementation of credit management initiatives. Although FmHA may have progressed in modernizing its automated systems, we believe that there are still significant internal control and credit management problems associated with those systems. For example, Agriculture's Federal Managers' Financial Integrity Act report, dated December 28, 1989, states that FmHA has not implemented software modifications for OMB Circular A-129 requirements such as assessing administrative costs, reporting to credit bureaus, classifying loans, screening applicants, reporting to IRS, and writing off loans. Further, OMB and Treasury have identified FmHA's automated systems as an impediment to implementing credit management initiatives.

Agriculture also took issue with our statement that FmHA's automated systems could not generate accurate and up-to-date account balances.

FmHA field offices do not verify account balances prior to FmHA authorizing IRS tax refund offsets. However, because this information may not be in the automated system, field offices verify account statuses, such as whether a borrower has a pending bankruptcy, before referring accounts to IRS. FmHA implemented this verification procedure in 1987 in order to reduce the number of borrower complaints and erroneous offsets. Also, field offices must manually verify accounts prior to referring delinquent accounts to credit bureaus. This is primarily because FmHA cannot rely on the accuracy and completeness of its account data because of the up-to-8-day delay in posting borrower payments, discussed in this chapter.

Education agreed with our recommendation that program managers be required to implement the procedures set forth in their agencies' regulations, such as requiring regularly scheduled site visits. In its comments, SBA reiterated its policy of regularly scheduled field office site visits to lenders. As discussed in the report, an SBA review of field office internal controls disclosed that 21 of the 67 offices reviewed did not comply with this policy. Therefore, we believe our recommendation to SBA is valid.

# Progress Made, but More Emphasis Needed on Collecting and Writing Off Delinquent Debt

It is imperative that federal agencies make every reasonable effort to collect delinquent debt. The Debt Collection Act of 1982 and other legislation gave agencies tools to implement successful delinquent debt collection procedures. Also, OMB's nine-point credit management program instructs federal agencies to (1) report accounts to credit bureaus, (2) offset federal income tax refunds, (3) offset federal employee salaries, (4) refer accounts to private collection firms, and (5) refer accounts to the agencys' general counsel or the Department of Justice for litigation. OMB directs agencies to use these delinquent debt collection tools within their overall collection strategy where they are most appropriate. In addition to collection tools, the nine-point credit management program instructs agencies to write off accounts that have been identified as uncollectible and to report closed-out debt to IRS as income to the debtor. Further, the Debt Collection Act of 1982 generally requires agencies to assess delinquent debtors interest, penalties, and administrative costs.

## More Can Be Done to Collect Delinquent Debt

In 1986, we reported that agencies were slow in implementing the Debt Collection Act of 1982. Though progress in implementing this act differed by agency, we found that most agencies were not (1) reporting delinquent accounts to credit bureaus, (2) offsetting federal income tax refunds or federal employee salaries, (3) using private collection firms, or (4) assessing delinquent debtors interest, penalties, and administrative costs. Further, some agencies were not reporting closed-out accounts to IRS as income to the debtor.

During this review, we found that, generally, the agencies we reviewed made progress in implementing these initiatives though more can be done to collect and write off delinquent debt. Since 1986, the agencies we reviewed made the most credit management progress in reporting accounts to credit bureaus and in offsetting federal income tax refunds and federal employee salaries. Although the use of private collection firms has increased, referrals of more accounts earlier in the collection process would improve agencies' collection activities. Also, several projects have been undertaken to improve the litigation of delinquent federal debt claims and decrease the litigation backlog. Limited progress, however, has been made in assessing interest, penalties, and administrative costs on delinquent debts.

## Eligible Accounts Generally Reported to Credit Bureaus

The Debt Collection Act of 1982 allows federal agencies to report delinquent consumer debt to credit bureaus after certain procedures[1] are satisfied. Use of this tool is intended to encourage delinquent debtors to make their accounts current, discourage current debtors from becoming delinquent, and provide information to federal credit granting agencies to identify applicants who are already delinquent on federal debts. Also, OMB Circular A-129 instructs federal agencies to report all commercial and delinquent consumer accounts in excess of $100 to credit bureaus. All of the agencies in our review, except FmHA, reported accounts to credit bureaus.

In April 1989, FmHA published regulations describing its procedures for reporting delinquent Single Family Housing accounts to credit bureaus. FmHA will report only accounts sent to IRS for tax refund offset. In fiscal year 1988, these accounts totaled about seven percent of the eligible delinquent Single Family Housing accounts. FmHA plans to report only those accounts sent to IRS for tax refund offset because automated system constraints require manual verification of all accounts to be sent to credit bureaus. This manual verification is necessary since the agency cannot rely on the accuracy and completeness of its account data. When its modified automated system for Single Family Housing is fully operational, FmHA plans to report all delinquent Single Family Housing accounts to credit bureaus. FmHA began to report Multifamily Housing accounts to credit bureaus in November 1989. As discussed in chapter 3, since agencies are not cross-checking with other federal agencies but are obtaining credit reports, full credit bureau reporting by all agencies is currently the most effective means for agencies to identify applicants who are delinquent on federal debt.

## Offset Programs Generally Successful

Federal agencies can use several different offset tools to collect delinquent debt. For example, IRS is authorized, until 1994, to offset taxpayer refunds to satisfy delinquent federal debts. Also, the Debt Collection Act of 1982 authorizes federal agencies to offset salaries of federal employees who owe delinquent federal debt. OMB Circular A-129 instructs federal agencies to use these tools.

One of the most successfully implemented delinquent debt collection tools is federal income tax refund offset. Treasury reported that since

[1]For example, agencies must notify delinquent consumer debtors in writing 60 days prior to referral that the debt is delinquent and that it will be referred to credit bureaus unless appropriate repayment arrangements are made.

inception of the program in 1986 through December 1988, the government collected $872 million. In 1988 alone, $349 million was collected in this program. We found that income tax refund offset was implemented for all of the programs we reviewed with consumer accounts except for VA's Vendee loans (loans made to purchasers of VA property inventory) and some of Education's Stafford loans. Agencies cannot use federal income tax refund offset to collect delinquent commercial debt because IRS has not developed the capability to offset those accounts. In commenting on this report, IRS stated that it is developing a test to determine the feasibility of a business refund offset program. However, it stated that because of the extensive administrative and system modifications to the current debtor master file that would be necessary, it is unlikely that a business offset program would be operational for 1992.

Because VA Vendee loans were not part of VA's automated receivable system, the agency could not offset federal income tax refunds.[2] In November 1988, VA modified its system and plans to use federal income tax refund offset in accordance with OMB requirements in 1990.

While Education accounted for about 72 percent of the government's tax refund offset collections, many delinquent Stafford loan program loans were not referred to IRS for offset. This was because Education generally relied on the guaranty agencies to select accounts to be assigned to Education for IRS offset purposes. Prior to fiscal year 1990, Education did not mandate the assignment of guaranty agency accounts to Education for IRS offset purposes because it did not have the systematic capability and capacity to track these accounts and collect them by other means. To the extent that Education can more efficiently collect than guarantors, it intends to exercise its mandatory assignment option when it is in the Federal fiscal interest to do so.

Another frequently used delinquent debt collection tool is federal employee salary offset. As of November 1988, the government collected $58 million in voluntary repayments and offsets of federal employee salaries. We found that all of the programs we reviewed with consumer accounts, except HUD's Single Family Housing program, had implemented federal employee salary offset.

[2]Prior to 1989, this also prevented VA from reporting accounts to credit bureaus, using private collection firms, and offsetting federal employee salaries for vendee loan accounts.

## Private Collection Firms Could Be Used More Extensively

The Debt Collection Act of 1982 allows federal agencies to use private collection firms to recover debts owed to the government. In addition, OMB Circular A-129 states that all accounts 6 months or more past due should be turned over to a collection firm unless the account is in an internal workout group,[3] eligible for offset, or in litigation.

Except for Education which separately contracts with private collection firms, the General Services Administration (GSA) contracts for the services of collection firms and makes them available to federal agencies. We previously reported[4] that some agencies were reluctant to use private collection firms because of their belief that (1) agency staff could collect the debt better, (2) collection agencies would not be sensitive to the programs' goals and objectives, and (3) collection agencies would concentrate on collecting easier debt.

Agencies have referred accounts to private collection firms sporadically. For example, our May 1987 report on private collection firms,[5] disclosed that during the first year of the GSA debt collection contract, agencies were slow in referring accounts to private collection firms. Specifically, in fiscal year 1986, more than 94 percent of the accounts referred were referred in the final 3 months of the fiscal year. In our current review, we found that during fiscal year 1988, more than 70 percent of the accounts referred were in the final 3 months of the fiscal year instead of during the normal collection process. In addition, although SBA and VA refer accounts to private collection firms, they do not routinely refer them after 6 months, as instructed by OMB Circular A-129. To realize optimum benefits from private collection firms, it is important that accounts be referred in the normal course of collection activities instead of concentrating referrals at the end of the fiscal year.

Education was the only agency extensively using private collection firms. For example, Education has been using private collection firms since 1981, and through fiscal year 1988, had referred over 1.5 million accounts valued at $2.4 billion. However, Education has not referred accounts to private collection firms since November 1988. Education's contracts with collection firms, which expired November 1989, stipulate

[3]A group within an agency whose sole purpose is to resolve, or attempt to resolve, seriously delinquent debts.

[4]Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

[5]Debt Collection: First Year Collection Efforts Under the GSA Contracts (GAO/AFMD-87-23, May 15, 1987).

that accounts will not be referred during the final year of the contracts. This is to give the collection firms ample time to work the accounts that were referred in the prior years and return all accounts to Education by the expiration of the contracts. While Education initially established the award date for February 1989, it now plans to award the contracts in early 1990. This was primarily because of delays on the part of the contractor developing Education's new debt collection system and Education's delays in awarding the new debt collection contracts. According to Education officials, in an attempt to better monitor and control contractor performance and to create competition among the private collection firms, the Department will require private collection firms, under the new contracts, to maintain accounts on its new debt collection system.

While Treasury encouraged the use of the GSA-contracted private collection firms in the interim, Education decided not to do this. Education officials informed us that GSA collection contractors were not used during this transition period because Education did not want to place accounts with these contractors and then have the accounts returned and placed with the new Education contractors. Further, the officials stated that they could not require the GSA contractors to maintain the accounts on the new Education debt collection system. Since Education does not plan to award the new private collection firm contracts until early 1990, the agency's decision not to use the GSA contractors will mean that no newly-acquired Education accounts were referred to private collection firms for over 1 year.

FmHA does not utilize collection firms. FmHA believes that its fiscal year 1987, 1988, 1989, and 1990 appropriation acts prohibit such use by stating that unless otherwise provided in the act, none of the funds appropriated or otherwise made available in the act could be used by the Farmers Home Administration to employ or otherwise contract with private debt collection agencies to collect delinquent payments. However, GAO (see footnote 5) and Agriculture's Office of the General Counsel agree that this appropriations authority neither prohibits nor requires FmHA to use GSA's debt collection contractors.

Also, HUD does not use private collection firms for its Single and Multifamily Housing programs. HUD chose to continue to use its own staff to collect delinquent Single and Multifamily Housing program loans because it believes it is more efficient. However, HUD does use private collection firms for its Title I program. In April 1989, HUD advised OMB and Treasury that it would continue to expand its use of private collection firms.

We fully support the continued use of private collection firms and OMB's directive that they be used earlier in the debt collection process. Using private collection firms is an effective means of providing agencies with additional resources for improving their debt collection capabilities at no cost to the agency (since the contractors' fees can be passed to the debtor). Agencies could improve their credit management programs if they routinely referred accounts in the normal course of their collection activities.

## Initiatives Implemented to Reduce Litigation Backlog

OMB's nine-point credit management program and OMB Circular A-129 instruct agencies to promptly refer seriously delinquent accounts to the agencies' General Counsel or the Department of Justice. As we testified in April 1988,[6] one of the most serious problems facing debt collection is a backlog of litigation. By the end of fiscal year 1988, Justice had 84,340 accounts worth $7.6 billion referred from agencies. Also, in fiscal year 1988 alone, Justice collected $479 million on delinquent agency debt. In addition, the general counsel's office at four of the five major credit agencies litigate certain accounts.

Due to recent concerns over the litigation backlog at the Department of Justice, several initiatives have been undertaken by Justice and some of the credit agencies to alleviate this problem. The following are examples of some of the steps taken during fiscal years 1987 and 1988 to address this problem:

- Justice started a 3-year pilot program to evaluate the use of private attorneys required by the Debt Collection Amendments (P.L. 99-578).
- In conjunction with this pilot program, Justice contracted for a computerized system, the Central Intake Facility, to receive all data on debts for the pilot districts. This facility is designed to serve as a data bank for all debts Justice receives for litigation.
- Justice increased VA's authority to litigate debts to $5,000.
- Agriculture's Office of the Inspector General is working with Justice to test the use of contract investigators in assisting with cases.

[6] Justice Department: Impediments Faced in Litigating and Collecting Debts Owed the Government (GAO/T-GGD-88-26, April 15, 1988).

## Interest, Penalties, and Administrative Costs Generally Not Charged

Unless otherwise prohibited by statute or contract, the Debt Collection Act of 1982 generally requires agencies to assess delinquent debtors (1) a minimum interest rate based on the average investment rate for the Treasury tax and loan accounts, (2) a penalty charge of up to 6 percent per annum for accounts more than 90 days past due, and (3) charges to cover the costs of processing and handling delinquent debt. In 1986, we reported that agencies were not collecting such interest, penalties, and administrative costs on delinquent debt. Since that time, the agencies we reviewed have made limited progress in this area. While none of the agencies in our review charged interest, penalties, and administrative costs as specified in the Debt Collection Act of 1982 or other applicable legislation, some agencies did assess some charges.

Although VA charges interest and administrative costs under the authority of the Veterans' Rehabilitation and Education Amendments of 1980, it does not charge the rate required by this law. This law specifies the interest rate and administrative costs to be charged to VA's delinquent debtors. To the extent not precluded by the terms of the loan agreement, the law requires that interest be accrued based on Treasury's borrowing rate, which for calendar year 1989 was 7 percent. However, as we reported in 1986 (see footnote 4), 1987,[7] 1988,[8] and 1989,[9] VA charges delinquent debtors four percent interest because of automated system constraints. VA determined that extensive reprogramming would be necessary to change to the interest rate prescribed by law, and this modification is expected to be completed by 1991. In our report on VA's fiscal year 1987 financial statements (see footnote 8), we recommended that VA reevaluate the priority given the computer software reprogramming workload to determine whether the modification to change the interest rate can be implemented earlier than 1991.

The Veterans' Rehabilitation and Education Amendments also require VA to charge delinquent debtors the administrative costs of collecting delinquent debt. To comply with this law, VA establishes an annual average cost of collecting delinquent debt which is added to the delinquent accounts monthly. VA also charges delinquent debtors the cost of litigation. Although VA does not charge the specific delinquent debtor the cost

[7] Financial Audit: Veterans Administration's Financial Statements for Fiscal Year 1986 (GAO/AFMD-87-38, July 29, 1987).

[8] Financial Audit: Veterans Administration's Financial Statements for Fiscal Years 1987 and 1986 (GAO/AFMD-89-23, November 30, 1988).

[9] Financial Audit: Veterans Administration's Financial Statements for Fiscal Years 1988 and 1987 (GAO/AFMD-89-69, September 15, 1989).

of using a private collection firm, a VA official told us that this cost is included in the annual average cost of collecting delinquent debt applied to delinquent accounts monthly. VA does not charge delinquent debtors a penalty because the Veterans' Rehabilitation and Education Amendments of 1980 do not provide for charging such a cost.

None of the other agencies in our review charged delinquent debtors additional interest as required by the Debt Collection Act. Also, only FmHA and HUD's Single and Multifamily Housing programs charged delinquent debtors a penalty. In August 1988, Education published regulations to assess an administrative charge on delinquent debt; however, according to an Education official, the agency will not implement the additional administrative charge until after the new private collection firm contracts are awarded.

The Debt Collection Act requires agencies to charge delinquent debtors the administrative costs related to collecting delinquent debts. In addition, OMB Circular A-129 instructs agencies to add the cost of private collection firms to the delinquent amount referred to the collection contractor. Except for Education, HUD (for its Single and Multifamily Housing programs), and SBA, agencies we reviewed were not assessing delinquent debtors administrative costs. In particular, only Education charges delinquent debtors the administrative costs of using private collection firms. However, HUD's Single and Multifamily Housing programs charge other types of administrative costs. HUD's Title I program does not assess administrative costs because they are not provided for in the original loan agreement. HUD officials informed us that the Department is revising its Title I regulations to permit HUD's administrative cost to be assessed to debtors. Currently, SBA attempts to recover the cost associated with liquidating the assets of defaulted borrowers. In addition, SBA plans to assess delinquent debtors the cost of using private collection firms in 1990 after its automated system is modified.

Although FmHA does not use private collection firms, the agency plans to assess other administrative charges such as a fee for using federal income tax refund offset. However, substantial automated system changes are needed prior to assessing such costs, but the modification to make these changes is inactive due to resources being redirected to implement provisions of the Housing and Community Development Act of 1987 and other automation priorities. The target date for implementing these changes is August 1991. Assessing interest, penalties, and administrative costs on delinquent debt is important as a deterrent against delinquencies and would help offset the costs of attempting to collect overdue accounts.

## Write-off and Close-out Procedures Need to Be Strengthened

At the end of fiscal year 1988, federal agencies reported over $14 billion in loans delinquent 360 days or more. This accounts for 6.4 percent of the loan receivables and represents an increase of 36.6 percent since the end of fiscal year 1985. Because of their age, many of these delinquencies are candidates for write-off. Since the probability of collection decreases as debts become older, good financial, program, and credit management dictates that delinquent accounts be periodically and systematically reviewed for write-off and close-out. Effective write-off and close-out procedures ensure proper accounting for the costs of credit programs and allow agencies to focus efforts on delinquent accounts with the greatest potential for collection. In addition, the nine-point credit management program instructs agencies to write off accounts that have been identified as uncollectible and to report closed-out accounts to IRS as income to the debtor.

OMB Circular A-129 and the Treasury Financial Manual credit supplement provide a two-step process as guidance for writing off and closing out accounts upon which collection activity has been terminated pursuant to the Federal Claims Collection Standards. In the first stage, agencies need to identify and remove uncollectible accounts through termination and write-off. The second stage involves closing out written-off accounts. Close-out consists of the administrative tasks which remain after termination and write-off, including, for example, reporting written-off debt to IRS as income to the delinquent debtor.

The agencies included in our review have instituted write-off and close-out procedures to varying degrees. However, in some instances, agencies' credit management programs could be strengthened by improving write-off and close-out procedures. We found that FmHA (for its Single Family Housing program), Education, and HUD need to further emphasize write-off procedures. Also, FmHA, SBA, VA (for its Veterans Loan Guaranty program), and HUD (for its Single Family and Multifamily Housing programs) do not report closed-out accounts to IRS as income to the debtor.

### More Emphasis Needed on Write-off Procedures

Although all agencies in our review have instituted write-off procedures, we found that FmHA's Single Family Housing program, Education, and HUD need to place more emphasis on them. In addition, in 1988, the

President's Council on Integrity and Efficiency[10] found that the write-off provisions of OMB Circular A-129 were not properly adhered to by federal agencies. Specifically, some agencies (1) did not properly establish claims, (2) did not write off seriously delinquent debt, and (3) prematurely wrote-off accounts before all collection efforts had been exhausted. An August 1988 Treasury task force on write-offs reported that write-off guidelines and regulations were frequently confusing, not sufficiently detailed, and not properly applied. The Treasury Financial Manual credit supplement issued in January 1989 provided comprehensive guidance on write-offs and close-outs.

If an FmHA Single Family Housing debtor is unable to pay his/her loan in full, FmHA will pursue a debt settlement. This settlement may include accepting less than the outstanding principal of the loan or writing off the debt. In August 1988, the Agriculture Inspector General reported that information submitted by debtors was seldom verified prior to processing and approving applications for debt settlement, and procedural guidelines were not sufficient to ensure effective and consistent processing of debt settlement cases. Further, the report questioned decisions to write off portions of farm and Single Family Housing debts when the debtor appeared to have the capability to repay all or a part of the amount owed in the two states reviewed. FmHA agreed to revise its debt settlement regulations in response to the report's recommendations.

Education, as well as the guaranty agencies participating in the Stafford loan program, have written off few loans. This was primarily because Education has not established write-off procedures for guaranty agencies and the Department's procedures do not comply with OMB Circular A-129. For example, for the accounts assigned from guaranty agencies, Education procedures do not differentiate between written-off and closed-out accounts. In commenting on a draft of this report, Education stated that Education and guarantors have been reluctant to write-off defaulted student loans because data shows that defaulted student loans, unlike other consumer loans, often become more collectible with age. Also, Education commented that it has drafted a directive setting forth its policy decision to write-off all loans which have reached the Federal statute of limitations (6 years) and close-out all loans which have reached the period of limitations for administrative offset (10 years). Education recently provided guaranty agencies with write-off

[10] President's Council on Integrity and Efficiency: Coordinated Review of Guaranteed Loans, Segment I, Implementation of the Administration's Nine Point Credit Management Program (September 15, 1988).

procedures and is currently revising its internal write-off and close-out procedures, which it plans to finalize in 1990.

While HUD writes off Title I debt, it does not write off debts under the Single and Multifamily Housing programs. Write-offs were not made in these programs because prior to 1988, HUD's procedures did not provide for a receivable being established for properties acquired by HUD through foreclosure. Thus, there was no amount to write off. In 1988, HUD published regulations to establish receivables in the Single Family Housing program for the difference between the amount owed by the debtor and the value of the acquired property. Currently, HUD is conducting a pilot program to determine the best method to implement these regulations. After the pilot, appropriate delinquent debts will be written off.

## Closed-Out Accounts Need to Be Reported to IRS

The Internal Revenue Code requires taxpayers to include some discharged debts in their calculations of gross income. This requirement includes debts closed out by federal agencies. Therefore, except in certain cases, such as Title 11 bankruptcy, IRS considers federal agencies closed-out debt income which the taxpayer should report. When federal agencies report closed-out debt, IRS matches this data against individual tax returns to determine if the debtor reported the closed-out debt as income which is then taxable. OMB Circular A-129 and the Treasury Financial Manual credit supplement direct agencies to report closed out accounts to IRS. HUD for its Title I program, VA for its vendee loan program, and Education report closed-out accounts to IRS as income to the debtor. However, FmHA, SBA, VA (for its Veterans Loan Guaranty program), and HUD (for its Single and Multifamily Housing programs) do not report closed-out accounts to IRS.

Agencies cite various reasons for not reporting closed-out accounts to IRS. FmHA does not report these accounts to IRS as income to the debtor because federal agencies are not specifically required by legislation to do so. Further, FmHA believes that reporting closed-out accounts to IRS as income to the debtor would generate negative public reaction. However, in commenting on our report, FmHA agreed to begin reporting closed-out accounts to IRS as income to the debtor early in 1990. While SBA has not reported closed-out debts to IRS, it intends to do so early in 1990. Although VA manually reported some closed-out Veterans Loan Guaranty accounts to IRS as income to the debtor, it suspended this reporting in June 1988 because of several state law suits which challenge the validity of establishing certain debts. (Vendee loans, however, are reported.) As previously mentioned, HUD is currently conducting a pilot program to close out Single Family Housing debts.

## Conclusions

Although the agencies we reviewed have progressed since 1986 in implementing delinquent debt collection tools, some significant debt collection and write-off procedures have not been adequately utilized. Specifically, except for FmHA, agencies we reviewed are reporting delinquent accounts to credit bureaus. Also, the five major credit agencies have been generally successful in implementing the IRS income tax refund and federal employee salary offset programs. However, IRS cannot accept commercial accounts for offset because of a lack of system capability.

In addition, agencies we reviewed have not fully utilized private collection firms. While referrals have been made, these have not been done as a routine step in the collection process. Although Education has extensively used private collection firms in the past, because of contracting and automated system problems, accounts have not been referred since November 1988. Although two agencies included in our review assessed penalties, four assessed some administrative costs, and one assessed interest, the agencies in our review have generally not assessed legislatively required interest, penalties, and administrative costs on delinquent debts. The use of these charges would serve as an incentive to delinquent debtors to repay and as a deterrent to future delinquencies. Also, these charges would generate revenue to the government which would offset at least some of the costs associated with collecting from delinquent debtors.

Three agencies included in our review have generally not established proper procedures for identifying and systematically writing off uncollectible debts, and four agencies did not report closed-out debt to IRS as income to the debtor. The guidance provided by OMB, Treasury, and the Federal Claims Collections Standards is sufficient for agencies to establish appropriate write-off and close-out procedures. It is essential for federal agencies to develop close-out procedures which cease collection activity on written off debts and report these debts, when appropriate, to IRS as income to the debtor. Removal of such accounts from agencies' receivables would allow agencies to place increased resources on those accounts which have a higher potential for collection. Also, the reporting of closed-out accounts to IRS, where appropriate, would provide for collecting the taxes applicable to the extra income realized by the debtor when a debt is closed out.

## Recommendations to Agencies

To improve debt collection and appropriately write off uncollectible accounts, we recommend that:

- The Administrator of the Farmers Home Administration require program managers to report eligible delinquent Rural Housing accounts to credit bureaus as soon as practicable.
- The Secretary of Education require the guaranty agencies to temporarily assign delinquent accounts to Education so that these accounts can be referred by Education to the Internal Revenue Service for federal income tax refund offset.
- The Secretaries of Housing and Urban Development and Veterans Affairs and the Administrator of the Small Business Administration require program managers to refer delinquent accounts to private collection firms in the normal course of their collection activities and in accordance with OMB Circular A-129.
- The Secretaries of the Departments of Education, Housing and Urban Development, and Veterans Affairs and the Administrators of the Small Business Administration and the Farmers Home Administration (for its Rural Housing loans), assess interest, penalties, and administrative costs on delinquent debts, pursuant to the Debt Collection Act or other applicable statutes.
- The Secretary of Housing and Urban Development and the Administrators of the Small Business Administration and the Farmers Home Administration (for its Rural Housing loans), report closed-out accounts to the Internal Revenue Service as income to the debtor.

## Agency Comments and Our Evaluation

OMB agreed that agencies cannot relax their efforts to recover delinquent debts and strongly emphasized its support for the continued use of debt collection tools such as tax refund offset, salary offset, referral of delinquent debtors to credit bureaus, and use of private collection firms. In particular, it agreed that private collection firms can be used more extensively and commented that Treasury will be reviewing delinquent debts due agencies to ensure full and timely referral. HUD agreed with our recommendation to refer delinquent debts to private collection firms in the normal course of its collection activity. SBA commented that it believes its philosophy of conducting a maximum internal collection effort prior to referring an account to a private collection firm is valid. The agency cited its extensive and effective field office network and that less than 1 percent of the dollar amount of all accounts referred was collected. SBA commented that after field office personnel have pursued all avenues available to them and consider a debt no longer collectible, they refer the account to a collection agency. We believe that if SBA exhausts all collection efforts before referring accounts to collection firms, then it can not reasonably expect private collection firm to have a high collection rate. We also believe that SBA should comply with OMB's requirement to refer accounts 6 months past due. SBA pointed out that, early in 1990, it would begin making more referrals of accounts at those field offices with high delinquency rates.

VA commented that it is referring debts to private collection agencies in the normal course of its collection activities and that OMB and Treasury have allowed VA to refer accounts 1 year past due. As we discussed in this report, agencies have tended to sporadically refer accounts to private collection agencies. As we pointed out, most of the accounts during the first year of the program and during fiscal year 1988 were referred during the last 3 months of the fiscal year instead of evenly throughout the year. Also, during fiscal year 1989, VA referred accounts to private collection firms in only 4 of 12 months. As pointed out in Treasury's comments to this report, agencies are faced with limited resources, and credit management activities often compete with program operations for these scarce resources. We believe that use of private collection firms can help compensate for these limited resources. We support OMB's requirement that agencies routinely refer accounts to private collection firms after they are 6 months overdue. As we stated in the report, we believe that this will optimize the benefits associated with using private collection firms.

HUD agreed with our recommendation to charge interest, penalties, and administrative costs in accordance with the Debt Collection Act. VA stated that it is currently responding to this recommendation under our 1986 report. (See footnote 4.) We addressed this issue again because it has been almost 4 years since this recommendation was made. SBA cited its current policy of charging interest on all loans. However, the interest and penalties referred to by SBA are the normal interest charges associated with the loan and are not the additional interest and penalty charges required by the Debt Collection Act of 1982. FmHA commented that it recently amended regulations to authorize collection of a fee for processing insufficient fund checks, but implementation is dependent upon software changes. While Education neither agreed nor disagreed with this recommendation, it stated that in fiscal year 1990, it will begin charging an administrative fee of $3 per account per month to defaulters to cover servicing costs. It also commented that, in many cases, Education can not assess penalties because the vast majority of promissory notes do not have a provision which allows the loan holder to assess penalties. This is one of the major reasons why we have made this recommendation. The Debt Collection Act was passed in 1982, but these loan agreements have not been revised to allow for the assessment of penalties required under the Act. We realize that Education is concerned that such penalties may become a disincentive to repayment, but the Congress specifically required the assessment of such penalties in the Debt Collection Act of 1982.

Education agreed with our recommendation to require guaranty agencies to temporarily assign delinquent accounts to Education so that these accounts can be referred to the Internal Revenue Service for federal income tax refund offset. The Department intends to use this mandatory assignment option when it is in the government's fiscal interest to do so.

HUD, SBA, and FmHA agreed with our recommendation to report closed out accounts to IRS. IRS also agreed with this recommendation and stated that agencies are required to report any accounts written off as uncollectible as income to the debtor.

# Additional Legislation Would Help Improve Credit Management

While agencies have progressed in implementing OMB's nine-point credit management program, there are additional opportunities for strengthening credit management. We have seen growing losses in recent years, and even these do not depict the full extent of our losses to date or our future risk of tens of billions of dollars in losses from these programs. It is incumbent on agencies to use all the credit management tools at their disposal, and they must improve the quality of accounting information so that the government knows where it stands on these programs.

Some of our solutions are not new. In our 1986 governmentwide report on federal agencies' implementation of the Debt Collection Act of 1982,[1] we recommended that a statutory requirement be provided for many of the debt collection tools available to federal agencies. We believe this will result in increased compliance. Since that report, several legislative proposals, such as the Federal Management Reorganization and Cost Control Act of 1986,[2] the Omnibus Debt Collection and Credit Management Act of 1986,[3] and the Federal Credit Management and Debt Collection Improvement Act of 1987,[4] have called for many of these tools. However, these proposals were not enacted. Nevertheless, we believe that many of the requirements in these proposals make sense. We believe that the federal government's overall credit management program would be strengthened by (1) amending the Debt Collection Act of 1982 to require federal agencies to use certain credit management tools and (2) providing agencies additional authority to manage credit programs and collect debts, such as allowing IRS to provide taxpayers' addresses to agencies under authority other than the Federal Claims Collection Act.

[1] Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

[2] S. 2230 (99th Cong.), introduced March 26, 1986.

[3] H.R. 4659 (99th Cong.), introduced April 22, 1986.

[4] S. 1270 (100th Cong.), introduced May 21, 1987.

## Credit Management Would Be Improved by Legislatively Requiring Certain Credit Management Tools

OMB's nine-point credit management program, Circular A-129, and the Treasury Financial Manual credit supplement provide a sound framework for managing federal credit programs. However, not every agency is following this guidance, and in some cases, as discussed previously, agencies are precluded from applying certain techniques and practices.

We support, where consistent with program legislation, legislating techniques and credit management practices such as prescreening loan applicants to determine (1) credit worthiness, (2) ability to repay, and (3) if they owe delinquent debts to the federal government. Further, the agencies should deny credit to applicants who owe delinquent debts to the federal government until satisfactory repayment arrangements are made. These credit management tools were discussed in chapter 3. In addition, credit management programs would be improved if agencies were legislatively required, where consistent with program legislation, to report delinquent accounts to credit bureaus, use private collection firms, and report closed out debt to IRS as income to the debtor.

We also believe that credit management would be improved if agencies required applicants, as a precondition to obtaining credit, to consent to tax information being obtained from IRS and then used in the loan approval process. However, we realize that this raises privacy and confidentiality issues and work load concerns for IRS. Therefore, we believe that this procedure should be performed on a test basis similar to that used for the tax refund offset program and the use of private sector attorneys to collect delinquent federal debt. This issue and IRS' concerns about it are discussed in the agency comments section of chapter 3.

## Credit Management Would Be Improved if IRS Provided Taxpayer Addresses to Agencies Under Authority Other Than Federal Claims Collection Act

The use of IRS taxpayer information is another area where legislation is needed. IRS has numerous taxpayer addresses which unfortunately agencies cannot always obtain to aid their collection efforts. In 1986, we recommended that the Congress amend the Debt Collection Act to explicitly authorize IRS to provide taxpayer address information to agencies pursuing debt collection activities under authorities other than the Federal Claims Collection Act. (See footnote 1.) The Federal Claims Collection Act, as amended by the Debt Collection Act, allows agencies to disclose taxpayer addresses obtained from IRS to their employees and agents for the purpose of locating delinquent debtors. IRS refuses to disclose addresses to agencies unless they cite the Federal Claims Collection Act as their collection authority.

In the 1986 report, we identified several agencies to which IRS had denied such access. IRS has denied such access to FmHA and the Federal Deposit Insurance Corporation because they cite legislation other than the Federal Claims Collection Act as their collection authority. For example, FmHA cites the Consolidated Farm and Rural Development Act, as amended, and the Housing Act of 1949, as amended, as its collection authority. An IRS official advised us that this situation has not changed since our 1986 report.

Although agencies can assert the Federal Claims Collection Act as authority to obtain IRS address information without abandoning their other claim authorities, the information obtained can only be used for purposes consistent with and authorized by that act. Use of taxpayer address information to accomplish collection under debt collection authorities, which may give the agency more authority to pursue collections, is prohibited.

Federal agencies' collection activities would be strengthened if the Congress amended the Federal Claims Collection Act to clarify the right of federal agencies to obtain and disclose IRS address information while pursuing debt collection activities under authorities other than this act. This would allow FmHA and other agencies to obtain IRS address information without having to narrow their claims collection process.

## Need for Reliable Financial Information on Credit Programs

Chapter 2 discussed agencies' reporting of receivable information and how the government's credit situation has continued to deteriorate. That chapter pointed out that the government's credit picture is worse than reported because of some agencies' inaccurate or inconsistent reporting of receivable information.

The Congress is provided information in OMB's budget documents on agencies' efforts to implement the nine-point program. For example, OMB's Management of the United States Government addresses agencies' activities related to the nine-point program. The Debt Collection Act requires OMB to annually report to the Congress on the management of agency debt collection activities.

As we recently reported,[5] growing losses indicate clearly the risks associated with these programs. In the past 3 fiscal years, for example,

[5]Federal Credit and Insurance: Programs May Require Increased Federal Assistance in the Future (GAO/AFMD-90-11, November 16, 1989).

defaults on guaranteed loans and loan delinquencies have increased substantially. However, the full magnitude of losses already incurred has not been reported because of long-standing deficiencies in financial management systems and the inconsistent application of accounting principles by some agencies responsible for administering federal credit assistance programs. It is apparent that federal financial assistance beyond that already provided by the government will be needed to pay for growing losses.

In order for the Congress and the Office of Management and Budget to make budgetary decisions and adequately plan for future funding of federal credit assistance and insurance programs, it is important that they be fully aware of certain factors. These include program costs in terms of losses, the amount of those costs being recovered through fees and premiums, the source of any financing being provided, and the amounts of the shortfalls.

In our 1986 report (see footnote 1), we also concluded that to ensure the reliability of financial data, agencies should be required to have periodic audits of receivable information. In that report, we recommended that the Congress amend the Debt Collection Act to require this, a recommendation we still believe valid. We also believe that agencies should provide audited receivable information to the Congress and notify their authorizing committees of their implementation of the credit management techniques addressed in this report so that the Congress can use this information, as well as information on agencies' efforts to implement the nine-point program, when making agency budgetary decisions.

## Conclusions

In 1986, we recommended that the Debt Collection Act be amended to provide a statutory basis for many of the debt collection tools available to federal agencies. We believe that by using all applicable credit management techniques, agencies would have effective comprehensive credit management programs. While some of these techniques are now included in OMB's Circular A-129 and the Treasury Financial Manual credit supplement, we continue to believe that a statutory basis for many of them would further encourage agency use and help ensure that these concepts are used by future administrations.

Also, reliable financial information on credit programs, as well as information on agencies' success in implementing the nine-point program, is important if policymakers, such as the Congress and the Administration, are to make sound decisions on the future of the government's credit management programs.

## Recommendations to the Congress

Because of the magnitude of the government's credit management problems, we recommend that the Congress amend the Debt Collection Act to require agencies, where consistent with program legislation to

- contract for debt collection services;
- offset salaries of government employees who owe delinquent debts;
- report information about an individual's delinquent debts to credit reporting agencies;
- use administrative offset to recover delinquent debts;
- prescreen loan applicants to determine credit worthiness, ability to repay, and if they owe delinquent debts to the federal government, including IRS;
- deny credit to applicants who owe delinquent debt to the federal government;
- refer all appropriate debts to IRS for the purpose of offsetting delinquent debtors' tax refunds; and
- report closed out debts to IRS as income to the debtor.

When enacting new credit programs or when reauthorizing existing programs, the Congress should specify the applicability of these techniques.

We also recommend that the Congress legislatively direct the Secretaries of the Departments of Housing and Urban Development and Veterans Affairs and the Administrators of the Farmers Home Administration and the Small Business Administration, in coordination with IRS, to test the use of consent forms for obtaining and using tax information in the loan making process. The affected agencies could designate selected programs, including those with guaranteed loans, for participation in the test.

We also recommend that the Congress require IRS to disclose address information to agencies pursuing debt collection activities under authorities in addition to the Federal Claims Collection Act.

In addition, we recommend that the Congress require agencies to provide it with (1) audited financial information on their receivables and delinquencies and (2) information on the implementation of the credit management techniques addressed in this report. The Congress could then use this, as well as information on agencies' efforts to implement the nine-point program, when making agency budgetary decisions.

## Agency Comments and Our Evaluation

Both OMB and Treasury agree there is a need for additional legislation to improve the government's credit management program. OMB agreed with our legislative proposals and commented that it would also like to see legislation implemented to (1) create a uniform system of enforcement procedures for the collection of federal debt, (2) make the tax refund offset program permanent, and (3) extend the Department of Justice's authority to use private sector attorneys to collect delinquent debts. OMB commented that flexibility should be built into any legislative changes so that agencies might implement a debt collection and credit management program that makes the best use of the tools and techniques under the nine-point program while not forcing an agency into the application of an initiative that is not appropriate or cost-effective. Treasury agreed that the Debt Collection Act needs to be strengthened, if only to clarify that the tools and techniques authorized by the act are not optional. It believes that any new legislation should require agencies to use all appropriate collection tools and that any legislative changes should consider the relationship between program legislation and credit management and the differences between direct and guaranteed loan programs. Treasury's comments also included specific legislative changes which it believes are needed.

Some of OMB's and Treasury's specific proposals parallel recommendations we have made. Others they present may have merit, but we did not evaluate them as part of this review. We also believe that the legislative proposals presented in this report are necessary if the government is to obtain maximum benefits from its credit management efforts. The legislative recommendations in this report do not call for a blanket legislative requirement for agencies to implement the nine-point program, but rather propose legislatively requiring certain tools which we believe, based on this report and our prior work in the area, are essential to good credit management. Further, our report and recommendations address the restrictions program legislation may place on credit management activities. We also believe that any new legislation should consider the differences between direct and guaranteed loan programs.

OMB agreed with the need for agencies to submit audited financial information on their receivables and delinquencies. It commented that this information would provide a useful indicator of the status of an agency's credit management program and serve as a method for alerting policy officers to emerging default trends and other credit problems.

OMB, IRS, and HUD agreed with our recommendation to broaden the authority to release taxpayer addresses for debt collection purposes.

# Summary of Changes in Receivable Information

This appendix provides information on the governmentwide changes, between fiscal years 1985 and 1988, for loans receivable, loan delinquencies, and loan write-offs.

**Table I.1: Change in Loan Receivables Between Fiscal Years 1985 and 1988**

Dollars in millions

| Agency | 1985 | 1988 | Percent change |
| --- | --- | --- | --- |
| Agency for International Development | $19,316 | $19,530 | 1.1 |
| Department of Agriculture | 126,789 | 117,510 | −7.3 |
| Department of Commerce | 879 | 569 | −35.3 |
| Department of Defense | 1,581 | 6,681 | 322.6 |
| Department of Education[a] | 16,069 | 11,956 | −25.6 |
| Export-Import Bank | 16,860 | 9,908 | −41.2 |
| Department of Health and Human Services | 638 | 804 | 26.0 |
| Department of Housing and Urban Development | 27,290 | 13,377 | −51.0 |
| Department of the Interior | 562 | 246 | −56.2 |
| Small Business Administration | 7,777 | 7,463 | −4.0 |
| Department of Transportation | 2,170 | 1,674 | −22.9 |
| Department of the Treasury | 4,791 | 3,565 | −25.6 |
| Department of Veterans Affairs[b] | 3,506 | 4,207 | 20.0 |
| All other | 29,967 | 26,454 | −11.7 |
| **Total** | **$258,195** | **$223,944** | **−13.3** |

[a]OMB included guarantees of Student Loan Marketing Association obligations in the "all other" category in fiscal year 1985 and in the Education category in fiscal year 1988. For consistency, we adjusted the fiscal year 1985 "all other" and Education categories to include the amount in Education.

[b]VA's loans receivable amount was adjusted to include VA's defaulted guaranteed loans, which VA reported as accounts receivable rather than loans receivable.

Source: Fiscal years 1987 and 1990 Management of the United States Government.

**Table I.2: Change in Loan Delinquencies Between Fiscal Years 1985 and 1988**

Dollars in millions

| Agency | 1985 | 1988 | Percent change |
|---|---|---|---|
| Agency for International Development | $130 | $334 | 156.9 |
| Department of Agriculture | 4,465 | 5,171 | 15.8 |
| Department of Commerce | 364 | 226 | −37.9 |
| Department of Defense | 20 | 101 | 405.0 |
| Department of Education | 3,636 | 5,475 | 50.6 |
| Export-Import Bank | 621 | 856 | 37.8 |
| Department of Health and Human Services | 12 | 55 | 358.3 |
| Department of Housing and Urban Development | 819 | 1,587 | 93.8 |
| Department of the Interior | 13 | 17 | 30.8 |
| Small Business Administration | 2,327 | 1,800 | −22.6 |
| Department of Transportation | 552 | 1,295 | 134.6 |
| Department of the Treasury | 98 | 100 | 2.0 |
| Department of Veterans Affairs[a] | 1,497 | 2,431 | 62.4 |
| All other | 88 | 15 | −83.0 |
| **Total** | **$14,642** | **$19,463** | **32.9** |

[a]VA's loan delinquencies were adjusted to include VA's defaulted guaranteed loans, which VA reported as accounts receivable rather than loans receivable.

Source: 1985 data — OMB debt collection reports.
1988 data — Agencies' Reports on Accounts and Loans Receivable Due From the Public as of September 30, 1988.

**Table I.3: Change in Loan Write-offs Between Fiscal Years 1985 and 1988**

Dollars in millions

| Agency | 1985 | 1988 | Percent change |
|---|---|---|---|
| Agency for International Development | $2 | $46 | 2,200.0 |
| Department of Agriculture | 155 | 1,704 | 999.4 |
| Department of Commerce | 35 | 147 | 320.0 |
| Department of Defense | 0 | 0 | • |
| Department of Education | 32 | 409 | 1,178.1 |
| Export-Import Bank | 4 | 0 | −100.0 |
| Department of Health and Human Services | 1 | 1 | 0.0 |
| Department of Housing and Urban Development | 424 | 17,394 | 4,002.4 |
| Department of the Interior | 1 | 381 | 38,000.0 |
| Small Business Administration | 462 | 493 | 6.7 |
| Department of Transportation | 0 | 359 | • |
| Department of the Treasury | 0 | 0 | • |
| Department of Veterans Affairs[a] | 57 | 222 | 289.5 |
| All other | 7 | 11 | 57.1 |
| **Total** | **$1,180** | **$21,167** | **1,693.8** |

[a]VA's loan write-offs were adjusted to include VA's defaulted guaranteed loans, which VA reported as accounts receivable rather than loans receivable.

Source: 1985 data — OMB debt collection reports.
1988 data — Agencies' Reports on Accounts and Loans Receivable Due From the Public as of September 30, 1988.

# Changes in Guaranteed Loans Outstanding and Terminations for Default

This appendix provides information on the governmentwide changes, between fiscal years 1985 and 1988, for guaranteed loans outstanding and guaranteed loan terminations for default.

**Table II.1: Change in Guaranteed Loans Outstanding Between Fiscal Years 1985 and 1988**

Dollars in millions

| Agency/Program | 1985 | 1988 | Percent change |
|---|---|---|---|
| Department of Agriculture | | | |
| Farmers Home Administration: | | | |
| Agricultural Credit Insurance Fund | $1,385 | $3,507 | 153.2 |
| Commodity Credit Corporation: | | | |
| Export Credit Guarantee Program | 5,094 | 4,919 | −3.4 |
| Department of Commerce | | | |
| Economic Development Revolving Fund | 235 | 123 | −47.7 |
| Department of Education | | | |
| Guaranteed (Stafford) Student Loans | 35,807 | 47,610 | 33.0 |
| Department of Housing and Urban Development | | | |
| Federal Housing Administration Loans | 195,480 | 300,758 | 53.9 |
| Small Business Administration | | | |
| Business and Investment Loans | 8,782 | 9,711 | 10.6 |
| Department of Transportation | | | |
| Maritime Administration: | | | |
| Federal Ship Financing Fund | 6,444 | 3,864 | −40.0 |
| Department of Veterans Affairs | | | |
| Loan Guaranty Revolving Fund | 130,591 | 149,705 | 14.6 |
| All other | 26,624 | 29,769 | 11.8 |
| **Total** | **$410,442** | **$549,966** | **34.0** |

Source: "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1987 and "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1990.

**Table II.2: Change in Terminations for Default Between Fiscal Years 1985 and 1988**

Dollars in millions

| Agency/Program | 1985 | 1988 | Percent change |
|---|---|---|---|
| Department of Agriculture | | | |
| Farmers Home Administration: | | | |
| Agricultural Credit Insurance Fund | $26 | $94 | 261.5 |
| Commodity Credit Corporation: | | | |
| Export Credit Guarantee Program | 185 | 272 | 47.0 |
| Department of Commerce | | | |
| Economic Development Revolving Fund | 103 | 3 | −97.1 |
| Department of Education | | | |
| Guaranteed (Stafford) Student Loans[a] | 1,018 | 1,438 | 41.3 |
| Department of Housing and Urban Development | | | |
| Federal Housing Administration Loans | 2,234 | 6,178 | 176.5 |
| Small Business Administration | | | |
| Business and Investment Loans | 476 | 465 | −2.3 |
| Department of Transportation | | | |
| Maritime Administration: | | | |
| Federal Ship Financing Fund | 321 | 181 | −43.6 |
| Department of Veterans Affairs | | | |
| Loan Guaranty Revolving Fund | 1,353 | 2,322 | 71.6 |
| All other | 361 | 242 | −33.0 |
| **Total** | **$6,077** | **$11,195** | **84.2** |

[a]This includes terminations that result in lender and guaranty agency liabilities.

Source: "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1987 and "Special Analysis F" of the Budget of the United States Government, Fiscal Year 1990.

# Comments From the Office of Management and Budget

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

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

February 26, 1990

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial Management Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Chapin:

Thank you for the opportunity to review the draft report "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine Point Program." The facts you cite of rising delinquencies and defaults in Federal loan receivables in the principal credit programs of the Departments of Agriculture, Education, Housing and Urban Development, and Veterans Affairs, are most worrisome. Equally of concern is the degree of minimal and noncompliance (excepting the Small Business Administration) with OMB's Nine Point Credit Management Program set out in Circular A-129.

See comment 1.

We agree with the main thrust of the report that much needs to be done. While valuable progress has been made in some agencies' credit management and debt collection procedures and accounting practices, we need to do much better. The Administration is committed to Federal agencies making significant improvements in their management of credit.

See comment 2.

Loan Origination. Although past efforts have focused primarily on delinquent debt collection, effective loan origination is critical to preventing future losses. We agree with GAO that agencies should comply with A-129 prescreening requirements. Agencies should require applicants to certify they are not currently delinquent on any Federal debt (with appropriate penalties for false certification) and that they were informed of Federal debt collection practices. If applicants for Federal credit are delinquent on other Federal debt, they generally should not receive additional Federal assistance. Legislative impediments to this principle (as with respect to Guaranteed Student Loans) should be removed so that every Federal agency--and each private sector lender for guaranteed loans--is required to ask about existing delinquencies and has the authority to deny credit where they exist. We strongly support legislation to this effect. The general rule should be that credit would be denied where delinquencies exist that are not being satisfactorily resolved.

See comment 3.

Use of credit bureau reports and the Department of Housing and Urban Development's prescreening system ("CAIVRS") would allow agencies to verify certification. All Privacy Act considerations on the question of the use of CAIVRS by other agencies have been resolved and OMB has issued an official opinion to this effect. The Department of Veterans Affairs (VA) will be implementing the use of CAIVRS later this spring.

See comment 4.

OMB believes that cross-checking against IRS delinquent tax files is a tool which agencies should begin using. We are working with IRS on a prototype match to identify and resolve specific operational problems and quantify benefits, including the use of the taxpayer consent form as recommended by GAO. We are committed to investigating with IRS faster automated methods of cross-checking. We will also explore the utility of using (within current statutory authority) data on delinquent tax status after loan origination to verify applicant certification.

See comment 5.

OMB continues to support recovery of servicing and collection costs through origination fees. However, as noted in the report, program legislation often prohibits fees or sets them at levels that do not recover full costs. The President's 1991 Budget proposes a number of new and increased fees, primarily for guaranteed loan programs. Programs covered include VA housing loan guarantees, most SBA loan guarantee programs, and Rural Electrification Administration loan guarantees.

See comment 6.

<u>Account Servicing and Management</u>. OMB strongly supports the report's conclusion that more needs to be done to improve loan servicing through upgraded financial systems. We have been working with agencies to test and implement improvements--such as the Farmers Home Administration (FmHA) servicing pilots and Education's new debt collection system. We also support consolidated servicing and collection activities at regional centers to improve loan servicing and address serious internal control problems, such as in Farmers Home county offices. As a general principle, staff responsibilities for loan origination and servicing functions should be separated. Financial systems that can produce accurate and timely data are needed for account servicing, delinquent debt collection, portfolio valuation, and risk analysis. With the help and support of GAO, we will continue our emphasis on improved financial systems.

See comment 7.

We believe OMB, Treasury, and GAO should give considerable thought to the form and content of data produced by credit program financial reporting systems. One improvement that we have been working on concerns the data on receivables and delinquencies reported by the agencies to the Department of the Treasury. The data are difficult to interpret because of the "mixing" of direct loans and guaranteed loan defaults which, when default claims are paid, become classified as direct loan receivables. Guaranteed

See comment 8.

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loan defaults are masking improvements by some agencies, such as the Department of Veterans Affairs, in the management of direct loans. We have been working with Treasury's Financial Management Service to separate receivable and delinquency data by type of credit. We hope to have this effort completed in time for our annual report to Congress required by the Debt Collection Act of 1982, as amended. Separate presentation and analysis of direct and guaranteed loan data will become even more important as the Government continues the shift from the use of direct loans to guaranteed loans to achieve program objectives.

See comment 9.

Loan Asset Sales. The Administration plans to continue its sale of loan assets where this proves cost-effective for the Government. Each proposed sale will undergo a rigorous economic analysis that compares--on a net present value basis--holding the loans to maturity to a prepayment program and to selling with recourse, partial recourse, or non-recourse to the Government.

See comment 10.

Delinquent Debt Collection. Even though our focus must shift to the front end of the credit cycle, we agree with GAO that agencies cannot relax their efforts to recover delinquent debt.

See comment 11.

The tax refund offset program has been one of our most successful debt collection techniques, with over $1 billion in recoveries to date. The authority for this program will not expire until 1994, but we should take advantage of any legislative opportunity to pass permanent authorization and ensure continued use of this valuable tool. OMB will continue to work with the Internal Revenue Service and the Department of the Treasury to monitor agency use of income tax refund offsets and ensure their fullest use. We are also considering whether guarantee agencies should assign to the IRS for offset defaulted accounts on which a claim has been paid.

See comment 12.

The use of tax refund offsets for delinquent debts owed by corporations is part of the President's Management By Objectives (MBO) system. While the IRS is experiencing some difficulty in meeting the target date for implementation (January 1991), Commissioner Goldberg and I are committed to moving forward promptly.

See comment 13.

Agency use of Federal salary offset was generally found to be satisfactory. We strongly support the principle that Federal employees must maintain an exemplary level of integrity, and will continue to require agencies to use salary offset as a tool to resolve delinquencies on Federal debt.

See comment 14.

All of the agencies in the review, except for FmHA, were reporting delinquent accounts to credit bureaus. FmHA began reporting multi-family housing borrowers to credit bureaus in November 1989. FmHA will also be required to report single-family housing accounts to credit bureaus.

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See comment 15.

We agree that private collection agencies can be used more extensively. The Financial Management Service will be reviewing agency delinquent debt to ensure full and timely referral. The issues raised in the report of delayed referral of debt six months delinquent and high end-of-year referrals will specifically be examined. The Department of Education reports that new contracts for its private collection agencies will be completed this month.

See comment 16.

As noted in the report, the Department of Justice is experiencing serious backlogs in litigating delinquent debt cases. The report also acknowledges some of the efforts that we have underway to correct this problem. These efforts are part of the President's MBO system and are being carried out by a litigation task force of the major credit agencies (headed by the Departments of the Treasury and Justice). The task force's efforts include simplifying and standardizing the forms and procedures to refer collectible cases to Justice for litigation, and automating Justice's litigation tracking system (including tying agencies into the system to allow automated referral).

See comment 17.

The Administration strongly supports legislation that would create a uniform system of enforcement procedures for the collection of Federal debt, to replace the variety of State procedures under which Federal debt must currently be collected. In addition, the authority for the Department of Justice to pilot test the use of private sector attorneys for debt collection cases will expire August 31 of this year. Because of lengthy procurement delays in activating the program, Justice has not been able to gather sufficient data to evaluate its effectiveness. The authority for the pilot program should be extended for another two years so this evaluation can be undertaken and a determination made on seeking permanent authority.

See comment 18.

Although agencies collected $256 million in late payment charges in 1989, we too are disappointed in the uneven implementation of the authority to charge interest and other penalties for delinquent debt. The problem is due to a confusing array of interest rates and other provisions. We are currently considering legislation that would standardize and simplify the late payment structure.

See comment 19.

Write-offs. The new write-off policy issued by Treasury in 1989 has greatly improved agency write-offs of uncollectible debt. Treasury will continue to review agency delinquent debt to ensure write-offs are occurring when appropriate. Treasury will also review the specific write-off deficiencies identified in the report and will work with the agencies to take the necessary corrective actions. We agree that write-offs must be reported to the IRS as income to the debtor. The Department of Education has recently made significant progress on write-offs, and the Department of Agriculture and the Small Business Administration this year will be reporting write-offs to the IRS for the first time.

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See comment 20.

Guaranteed Loan Management. One issue that cuts across the entire credit cycle is the management of guaranteed loans. As noted above, the use of guaranteed loans is increasing, and poses a significant potential liability to the Government. Secretary Kemp has taken a number of aggressive and positive actions to correct problems in the Department of Housing and Urban Development's guaranteed loan programs. We need strong management controls to prevent losses in other agencies' programs, and early warning systems to identify any problems that might be developing. As you heard at the January 31 meeting of the Federal Credit Policy Working Group, a special task group is currently developing recommendations for improved management of guaranteed loans. Specific recommendations will be available later this month; we will share them with you.

See comment 21.

In the meantime, let me just note that we agree that front-end controls on credit extension and guidelines for lender performance and monitoring are needed for guaranteed loans. We also agree that formal written agreements should be required from lenders receiving Federal guarantees to protect the Government's interest, and that reviews of lender compliance should be conducted (with penalties imposed for non-compliance).

See comment 22.

Credit Management Legislation. The report's major recommendation is that legislation be enacted to make mandatory the use of the Nine Point Credit Management Program. We agree that such legislation would clarify some issues and help ensure a more consistent application of the Nine Point Program. However, legislation is never the complete answer; there must be leadership and commitment to improved credit management from agency and Administration officials. Many of the credit programs are heavily decentralized, and as a result the implementation of national credit management policies and techniques is not an easy task. We need better policies; but we also need much more vigor in their implementation at all levels. As Chairman of the Federal Credit Policy Working Group, I am committed to these goals.

See comment 23.

The recommendation to require statutorily that credit agencies submit audited financial information on receivables is a good one. This information would not only provide a useful indicator of the status of an agency's credit management program, but it could also serve as a method for alerting policy officers to emerging default trends and other credit problems. OMB is working with the Chief Financial Officers' Council and the Federal Credit Policy Working Group to define requirements for, and the scope of, audited financial statements and to identify which programs can most benefit from the preparation and issuance of financial statements. We would be pleased if you joined us in our review and the implementation process.

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In drafting any legislation, flexibility should be built in so that agencies might implement a debt collection and credit management program that makes the best use of the tools and techniques available under the Nine Point Program. Because credit program authorities, types of borrowers, and portfolio characteristics vary, different agencies may need to apply the Nine Point Program differently. Therefore, any legislation would need to ensure use of the Nine Point Program while not forcing an agency into the application of an initiative that is not appropriate or cost-effective.

See comment 24.

Within this context, we would support the recommendation that Congress amend the Debt Collection Act to require agencies to use the Nine Point Program initiatives. Our staff will be working with the agencies and would be happy to work with GAO on specific language suggestions. We also support the recommendation that Congress require the IRS to disclose address information to agencies pursuing debt collection activities under authorities in addition to the Federal Claims Collection Act.

See comment 25.

Improving credit management remains a sizable task, and the interest and support of the General Accounting Office, Congressman Kasich, and others in the Congress is extremely helpful. We would be interested in exploring opportunities for cooperative efforts with the GAO in improving credit management.

Thank you for the opportunity to comment on a very thorough and insightful report, and for your presentation of the report at the meeting of the Federal Credit Policy Working Group.

Sincerely,

Frank Hodsoll

Frank Hodsoll
Executive Associate Director

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The following are GAO comments on the Office of Management and Budget's letter dated February 26, 1990.

## GAO Comments

1. Addressed in Executive Summary.

2. Addressed in Executive Summary.

3. Addressed in Executive Summary and agency comments section of chapter 3.

4. Modified report to include OMB's opinion on the use of CAIVRS.

5. Addressed in agency comments section of chapter 3.

6. Addressed in agency comments section of chapter 3.

7. Addressed in Executive Summary and agency comments section of chapter 4.

8. We agree that data on receivables and delinquencies reported by the agencies to Treasury are difficult to interpret because of the "mixing" of direct loans and guaranteed loan defaults. We believe OMB's and Treasury's efforts to separate this receivable data will provide useful credit management information.

9. Report modified to explain that the administration plans to continue its sale of loan assets where this proves cost-effective for the government.

10. Addressed in agency comments section of chapter 5.

11. Addressed in agency comments section of chapter 6.

12. Report modified to explain that it is unlikely that a business offset program would be operational for 1992.

13. No change to report necessary.

14. Report clarified to explain that FmHA began reporting Multifamily Housing accounts to credit borrowers.

15. Addressed in agency comments section of chapter 5.

16. No change to report necessary.

17. Addressed in agency comments section of chapter 6.

18. No change to report necessary.

19. Report changed to include this information.

20. Addressed in agency comments section of chapter 4.

21. Addressed in agency comments section of chapter 4.

22. Addressed in Executive Summary and agency comments section of chapter 6.

23. Addressed in Executive Summary and agency comments section of chapter 6.

24. Addressed in agency comments section of chapter 6.

25. Addressed in agency comments section of chapter 6.

# Comments From the Department of the Treasury's Financial Management Service

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

DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20227

December 21, 1989

Dear Mr. Chapin:

We have reviewed your draft report entitled "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine Point Program", dated December 1989. As you noted, the credit management program has made a very real contribution to improved management of the Government's credit programs and continued implementation is essential if we are to make long-term, permanent changes in the Federal government's financial management practices. It is especially critical that agencies improve their financial reporting systems and move toward accrual based financial statements so that we can quantify our risk exposure and have "early warning" of potential financial disaster.

See comment 1.

See comment 2.

We offer the following general comments:

See comment 3.

1. On the face of it, the numbers do indicate a deterioration in the agencies' portfolios. However, they indicate much more:

   - Decreasing receivables. Between 1985 and 1988, receivables decreased $34.3 billion. This decrease is attributable to loan asset sales and prepayments of almost $21 billion and to the legislatively-mandated Department of Housing and Urban Development Low Rent Public Housing forgiveness program of $21 billion. The sales and forgiveness programs involved non-delinquent loans and thus did not affect total delinquencies.

   - Better accuracy in agency reporting. We are beginning to see the results of the concerted effort, begun in 1985 by OMB and FMS, to improve agency reporting. In the short run, the improved reporting will make the Government's financial situation look worse.

   - Increasing defaulted guarantees. It is true that defaulted guarantees are increasing and that these increases are showing up in the agencies' delinquencies. This situation will continue until the Government implements improvements in guaranteed loan management. The Guaranteed Loan Management Project, undertaken jointly by OMB and FMS, to address guaranteed loan issues, will promulgate standards for the management of Federally guaranteed loan programs.

See comment 4.

2. Most of the programs covered in the report are guaranteed loan programs. Agencies face different problems with guaranteed loan programs than with direct loan programs

Page 2 - Mr. Chapin

since the agency is not dealing directly with a borrower, but with and through a lender. Historically, this has made it more difficult for an agency to impose or dictate borrower/debtor requirements. We believe that the perceived enforcement difficulties as they relate to guaranteed loans need to be acknowledged.

See comment 5.

3. We agree that agencies need to fully implement appropriate credit management tools and monitor their lenders. There is, however, a priority and resource issue not addressed in the report. Agencies have many priorities, with credit management often seen as competing with, rather than complementing, program operations for scarce resources. Resources are and continue to be an issue with the agencies, particularly as requirements for agencies to monitor and review lenders increase.

See comment 6.
Now on p. 65.

4. We found the report misleading in its discussion of write-offs (page 89). The findings of the FMS Write-off Task Force regarding the inadequacy of Government write-off policies preceded the issuance of the Treasury Financial Manual Credit Supplement (Supplement). The Supplement provided the needed comprehensive guidance on write-off and close out.

See comment 7.

5. We agree that the Debt Collection Act of 1982, as amended, needs to be strengthened, if only to clarify that the tools and techniques authorized by the DCA are not optional. Any new legislation should require agencies to use all appropriate collection tools, for example, credit bureaus and collection agencies, but should not legislate implementation of the Nine Point Credit Management Plan since that could prove to be very limiting. In addition, any legislative change needs to address:

   - o the relationship between credit management requirements and agencies' authorizing legislation, in terms of which takes priority and

   - o the differences between direct and guaranteed loan management, in terms of how the agencies are expected to apply specific tools for guaranteed loans.

   Specific legislative changes which we would like to see include:

   - o amending the DCA's definition of person to include State and local governments, thereby making such governments subject to administrative offset;

Page 3 - Mr. Chapin

- o allowing agencies to retain administrative charges assessed on delinquencies to make credit management improvements as an incentive to assess such charges;
- o simplifying the interest, penalty and administrative charges requirements by merging the interest and penalty charges into a single late fee;
- o expanding the Department of the Treasury's current authority to mandate the use of cash management tools to include credit management tools and techniques.

We believe that we have a mechanism in place, with the Economic Policy Council Working Group on Federal Credit Policy (Working Group), to obtain the visibility and senior level management involvement necessary to ensure the continuation and expansion of the credit management program. Secretary Brady has indicated his willingness to take any proposals developed by the Working Group to the Economic Policy Council for consideration. GAO's report will be helpful in maintaining the pressure to improve governmentwide credit management.

We appreciate being given the opportunity to comment. If you have any questions, please contact Victoria I. McDowell, Director of the Credit Administration Division, on 287-0665.

Sincerely,

Michael T. Smokovich
Assistant Commissioner
Federal Finance

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial
Management Division
General Accounting Office
Washington, DC 20548

The following are GAO's comments on the Department of the Treasury's Financial Management Service's letter dated December 21, 1989.

## GAO Comments

1. Discussed in agency comments section of chapter 3.

2. Discussed in agency comments section of chapter 2.

3. Discussed in agency comments section of chapter 2.

4. Discussed in agency comments section of chapter 2.

5. Discussed in agency comments section of chapter 4.

6. Report changed to include this information.

7. Discussed in agency comments section of chapter 6.

# Comments From the Department of the Treasury's Internal Revenue Service

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

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

JAN 24 1990

Mr. Donald Chapin
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Chapin:

We have reviewed your recent draft report entitled, "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program".

Overall, we agree with the report's findings that the Federal government's credit picture can be improved through full implementation of the credit management initiatives outlined in OMB's credit program. Included in this program is the disclosure of certain tax information by IRS to Federal agencies, the referral of delinquent loans to IRS for offset of income tax refunds, and the reporting of closed out accounts as income to the debtor to the IRS.

See comment 1.

We would take the opportunity to point out that the use of the refund offset program, while highly successful, carries some risk. Recent IRS studies indicate that taxpayers whose refunds are offset tend to be more noncompliant. While we continue our studies in this area, we believe that expansion of the refund offset program should be approached cautiously.

See comment 2.

Also, we have long been concerned over the impact that disclosing tax information for non-tax purposes can have on taxpayers' confidence in the tax system. Accordingly, we believe that minimum criteria should be met before Congress agrees to expanding disclosure authority for non-tax purposes. First, there must be a demonstrated need for the information. Second, Federal agencies must have explored all possible means of obtaining the information and found access to tax information to be the only feasible means. Third, the benefits from using tax information should be substantial and should significantly outweigh the costs of obtaining and using the information. Finally, agencies receiving tax information must be strongly committed to safeguarding information in their possession in order to maintain taxpayers' confidence that their tax information will remain confidential.

We have enclosed detailed comments on the report recommendations as well as additional comments regarding certain statements made in the report. We hope these comments are useful.

Best regards.

Sincerely,

Fred T. Goldberg, Jr.

Enclosure

CREDIT MANAGEMENT: DETERIORATING CREDIT PICTURE EMPHASIZES IMPORTANCE OF OMB'S NINE-POINT PROGRAM

RECOMMENDATION 1:

To improve loan origination procedures, we recommend that the Director of the Office of Management and Budget and the Secretary of the Treasury, in conjunction with the Internal Revenue Service and affected agencies, resolve impediments to prescreening applicants against delinquent tax accounts. We also recommend that the Secretaries of the Departments of Housing and Urban Development and Veterans Affairs, and the Administrators of the Farmers Home Administration and the Small Business Administration require that program managers and private lenders obtain loan applicants' consent to obtain tax information from IRS. (Page 59 of the draft report.)

Comment:

See comment 3.

The IRS opposes the use of taxpayer consents to obtain tax information that is otherwise available under a specific provision of the Internal Revenue Code. In 1982, Congress amended section 6103 of the Code, which governs the disclosure of tax information, by adding subsection 6103(l)(3). Under this subsection, IRS can, upon written request, disclose to the head of a Federal agency administering certain Federal loan programs whether or not a loan applicant has a delinquent tax account with the IRS. In making this amendment, Congress determined that agencies receiving this information should properly safeguard tax information in its possession. In addition, unauthorized disclosures of this information subject the agency to civil and criminal penalties.

The suggested use of waivers from taxpayers, in an attempt to obtain this information more expeditiously, undermines the safeguard and security measures applicable to information released under subsection 6103(l)(3). Agencies receiving tax information pursuant to a taxpayer consent are not required to safeguard the information, nor are they subject to penalties for unauthorized disclosure.

In addition, the use of taxpayer consents in this context raise some of the same issues addressed in Tierney v. Schweiker, 718 F.2d 449 (D.C. Cir. 1983), where the court expressed concern about the use of consents as a "catch all" mechanism to circumvent the general rule of confidentiality established by Congress. The court also found that coerced waivers could not be honored by the IRS. We believe that agencies' use of required waivers will face similar legal challenges.

-2-

The use of large volumes of taxpayer consents would create a considerable added burden on the IRS. In addition, it is unlikely that Federal agencies can obtain this data more quickly using a consent from the taxpayer than under current procedures for subsection 6103(1)(3). The IRS would be happy to work with agencies to obtain this information as quickly as possible using our current information systems.

These comments are equally applicable to the report's recommendations to Congress on amending the Debt Collection Act of 1982 (pages 102-103 of the report).

RECOMMENDATION 2:

To improve debt collection and appropriately write off uncollectible accounts, we recommend that the Secretary of Education require the guaranty agencies to temporarily assign delinquent accounts to Education so that these accounts can be referred by Education to the IRS for Federal income tax refund offset. (Page 94 of the draft report.)

Now on p. 68.

Comment:

See comment 4.

In order for a debt to be eligible for refund offset, the debt must be a legally enforceable debt owed to a Federal agency, 31 U.S.C. 3720A(a). We are not certain what is contemplated by a temporary assignment of a debt to the agency. Although the IRS in its ministerial role with regard to refund offset would not question the referral of such debts for offset, legal challenges appear likely where offset is used as a mechanism for paying the debt actually owed to the guaranty agency rather than to the Department of Education.

Recommendation 3:

To improve debt collection and appropriately write off uncollectible accounts, we recommend that the Secretary of Housing and Urban Development and the Administrators of the Small Business Administration and the Farmers Home Administration (for its Rural Housing loans) report closed-out accounts to the IRS as income to the debtor.

-3-

Comment:

See comment 5.

We agree with this recommendation. Agencies are required to report to the IRS any accounts written off as uncollectible as income to the debtor on Form 1099G.

RECOMMENDATION 4:

We also recommend that the Congress require IRS to disclose address information to agencies pursuing debt collection activities under authorities in addition to the Federal Claims Collection Act. (Page 103 of the draft report.)

Now on p. 75.

Comment:

See comment 6.

The IRS does not oppose a broadening of the authority in subsection 6103(m)(2) to release taxpayer address information for debt collection purposes under other statutory authorities than the Federal Claims Collection Act. Current authority under subsection 6103(m)(2) is restricted to that Act. IRS would prefer that the additional authority be specifically spelled out in any amendment to subsection 6103(m)(2).

We would point out that the IRS is becoming more deeply involved in Federal government debt collection process. Given this involvement, Congress may wish to consider looking at the entire loan screening and debt collection area and combine existing tax information disclosure authority in the Internal Revenue Code. Currently, there are separate disclosure provisions related to debt collection in subsections 6103(1)(3), (1)(10), (m)(2), (m)(4), and (m)(5), and to a lesser extent subsections (1)(6) and (1)(8). Conceivably, these could be combined into a single loan application/debt collection section. This section could provide for better coordination and internal consistency in the disclosure of tax information.

Finally, with regard to legislative changes, we suggest that there should be reciprocity in the exchange of address information. That is, agencies should also be required to provide IRS with address information on taxpayers who are in the loan origination phase. For those loan applicants with tax delinquencies, this information would be useful to the IRS' enforcement functions.

ADDITIONAL COMMENTS

We have the following comments on other statements in the report.

Corporate Offset Program

See comment 7.
Now on p. 58.

The report states that IRS has not developed the capability to offset commercial accounts (page 78). Actually, the IRS is in the process of developing a test to determine the feasibility of a business refund offset program. This test includes a statistical analysis of corporate accounts to determine the short-term cost-effectiveness of collecting delinquent corporate debt through a business refund offset program.

The report also states that IRS will not be able to offset commercial accounts until 1992 at the earliest (page 78). However, once the results of the feasibility study are complete, implementation of a business offset program would require extensive administrative and systemic modifications to the current Debtor Master File. It is unlikely that a business offset program would be operational for 1992.

Private Collection Firms Could Be Used More Extensively

See comment 8.
Now on p. 59.

The report states that the Debt Collection Act of 1982 allows Federal agencies to use private collection firms to recover debts owed to the government, but that agencies have referred accounts to private collection firms sporadically (pp. 79-80). IRS recommends that debts should be referred to private collection firms before these debts become eligible for referral to the IRS' refund offset program. IRS' studies of the refund offset program have detected an increase in noncompliance for taxpayers whose refunds are offset. Accordingly, IRS believes that every other avenue of collection should be exhausted before these debts are referred to the IRS.

Loan Servicing Limitations of Farmers Home Administration's (FmHA's) Current System

See comment 9.
Now on p. 51.

The report states that the Agriculture Inspector General has issued several reports detailing problems with FmHA's automated system, such as inaccurate data on loan delinquencies (page 70). Although the report indicates that FmHA field offices verify the account status of all accounts for refund offset, the report does not provide an assessment of the accuracy of these field office data. This raises a concern for IRS-- whether FmHA is referring accurate debtor information to the IRS' refund offset program.

-5-

It is essential that IRS receive accurate information from the agencies in order to avoid either offsetting taxpayers without delinquent debts, or offsetting taxpayers for amounts in excess of their loan delinquencies. In each of these situations, a taxpayer can file a claim for the appropriate amount of an offset to be refunded to them. This process places additional burden on IRS operations and generates negative publicity for the IRS.

The following are GAO's comments on the Department of the Treasury's Internal Revenue Service's letter dated January 24, 1990.

## GAO Comments

1. While we fully support the tax refund offset program as a debt collection tool, we are currently evaluating the extent, if any, by which the refund offset program reduces taxpayer compliance.

2. Addressed in agency comments section of chapter 3.

3. Addressed in agency comments section of chapter 3.

4. Because these are claims paid by the federal government, we believe they are legally enforceable.

5. Addressed in agency comments section of chapter 5.

6. Addressed in agency comments section of chapter 6.

7. Report clarified.

8. Although we support the use of private collection firms, we disagree that they should always be used before delinquent debtors' tax refunds are offset. Agencies should develop appropriate debt collection strategies. In those situations where it is more effective to use tax refund offset before private collection firms, this should be done. Further, OMB's Circular A-129 states that an agency can initiate the income tax refund offset process at any point in the delinquent debt collection cycle.

9. We agree that it is essential that IRS receive accurate information from agencies when offsetting tax refunds, but the scope of our review did not include an assessment of the accuracy of FmHA's field office data.

# Comments From the Department of Agriculture

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

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

DEC 22 1989

SUBJECT: GAO Draft Report (AFMD-90-12), Dated December 1989, Entitled, "CREDIT MANAGEMENT: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program"

TO: Donald H. Chapin
Assistant Comptroller General
Accounting and Financial Management Division

Attached are FmHA comments to subject draft report.

If we can be of further assistance, please contact Leonard Hardy, Director, Planning and Analysis Staff 475-5300.

ROLAND R. VAUTOUR
Under Secretary
Small Community and Rural Development

Attachment

GAO DRAFT REPORT (AFMD-90-12, DATED DECEMBER 1989, ENTITLED,
"CREDIT MANAGEMENT: DETERIORATING CREDIT PICTURE EMPHASIZES
IMPORTANCE OF OMB'S NINE-POINT PROGRAM"

General Comments

See comment 1.

See comment 2.

In order to improve the clarity of the report, we suggest Chapters 1 and 2 be combined. Much of the data in these two Chapters is duplicated and causes the report to be redundant. We also suggest the financial condition of the Rural Housing programs be included in the report since the recommendations relate only to that program. The report cites some large delinquency statistics for FmHA, but does not break them down by program. It recognizes on page 18 that the majority of these delinquencies are in our Farmer Program loans. In fact, about 95 percent of the delinquencies are in Farmer Programs and the remaining 5 percent in the Housing Programs. As reported on the September 30, 1989, Schedule 9 report, delinquencies in the Rural Housing Insurance Fund, using Treasury's delinquency definition, was $1.504 billion out of a total principal and interest balance of $28.236 billion. Of this delinquent amount, $487 million was in litigation at the Office of General Counsel or Department of Justice.

See comment 3.
Now on p. 20.

On page 23, the report states FmHA had "loan losses of about $22 billion in fiscal year 1989." This is misleading to someone unfamiliar with FmHA's financial situation. This amount is the allowance for loss, not the Agency's actual 1987 losses. FmHA recognized in 1987 that its loss allowance was inadequate and made a substantial adjustment to the allowance to more accurately reflect several years of deterioration in the agricultural portfolio. Actual losses in FY 1987 were about $1.4 billion.

See comment 4.
Now on p. 47.

We also note the comment on page 63 that the Administration plans to continue asset sales. FmHA has no new asset sale authority in FY 1990 and we understand sales are very limited Governmentwide. We suggest this sentence be removed.

See comment 5.

GAO Recommendation 1

Automated system problems hinder FmHA servicing.

Departmental Response

See comment 6.
Now on pp. 51 and 52.

We do not believe the comments on pages 70-72 accurately and fairly present all facts pertinent to FmHA's automated system. As to the alleged inability of the system to generate accurate and up-to-date account balances, the system balances have served the Agency in two asset sales amounting to millions of dollars. While the firm of Price Waterhouse did not conduct a full audit as part of these sales, they reviewed FmHA's cash-flow on the loans subject to sale at the request of the underwriter. In addition, GAO has audited FmHA's financial statements and has reported problems only in the areas of acquired property and allowances for losses.

Moreover, field offices are not requested to verify the account balances on accounts sent for IRS tax refund offset. While the system could automatically select borrowers for offset, field offices are given the opportunity to exclude borrowers as a safeguard because of the legal ramifications of tax refund offset.

FmHA has made significant progress in the 80's to modernize its automated system. Substantial investments and improvements have been made to make the system more responsive to meeting the Agency's mission. An example of this progress, FmHA is in the process of contracting out the privatization of single family housing billing, escrowing, and accounting on a pilot basis. Also multifunction work stations have been installed in field offices nationwide to provide high volume loan making and loan servicing transaction input capability to local field offices giving them control over the accuracy of their accounts. Borrower account status screens are available to field offices for determining account balances on an as-needed basis. Also, history is available online for all borrower accounts reflecting up to 15 months of transactions posted to borrower accounts.

FmHA has also implemented lockbox capabilities with respect to rural housing loans allowing up to 70 percent of borrower payments to be posted to accounts on a 24- to 48- hour turnaround basis. As to the Federal Managers' Financial Integrity Act, FmHA has corrected 30 of the 36 material accounting system weaknesses reported.

GAO Recommendation 2

The Administrator of the Farmers Home Administration--for FmHA's Rural Housing programs--require that program managers and private lenders modify loan applications to include a signed borrower's certification that the borrower has been advised of and understands the government's debt collection practices.

Departmental Response

See comment 7.

The regulations requiring FmHA borrowers to sign a certification statement were published on August 12, 1989.

GAO Recommendation 3

FmHA does not report Multi Family Housing accounts to credit bureaus.

Department Response

See comment 8.

FmHA began to report those borrowers in November 1989.

GAO Recommendation 4

See comment 9.

FmHA does not utilize collection firms.

Departmental Response

See comment 10.

We are not aware of an OGC opinion or other basis for the comment on page 82 that OGC agrees that referenced appropriation authority, "neither prohibits nor requires FmHA to use GSA's debt collection contractors."

GAO Recommendation 5

Agencies are not assessing delinquent debtors administrative costs.

Departmental Response

See comment 11.
Now on p. 63.

In addition to charging an administrative fee for income tax refund offset as discussed on page 87, FmHA will also charge a fee for processing checks returned for nonsufficient funds. The regulations were recently amended to authorize this fee, but implementation is dependent upon the completion of software changes.

GAO Recommendation 6

See comment 12.

FmHA's Single Family Housing program needs to place more emphasis on write-off procedures.

Departmental Response

FmHA is working on a revision of SFH servicing regulations to address the need to seek deficiency judgments, after a foreclosure, when the foreclosure sale purchase price is less than the unpaid balance on the debt.

GAO Recommendation 7

Farmers Homes Administration (for its Rural Housing loans), report closed-out accounts to the Internal Revenue Service as income to the debtor.

Departmental Response

FmHA will begin reporting discharged debts to the Internal Revenue Service in January 1990 as recommended.

The following are GAO's comments on the Department of Agriculture's letter dated December 22, 1989.

## GAO Comments

1. No change to report necessary.

2. No change to report necessary. As explained in chapter 1, this chapter is concerned with the reasons for changes in loan data at the governmentwide and agency level. We believe that we have adequately explained that Agriculture's loan data indicators were influenced by the financial problems in the farm economy. In addition, FmHA's Rural Housing program experienced the same deteriorating loan condition as Agriculture as a whole. Between fiscal years 1985 and 1988, the Rural Housing program's loans receivables decreased by about 7.9 percent while delinquencies and write-offs increased by approximately 91 percent and 233 percent, respectively.

3. Revised report to address allowance for loan and interest losses and to update the report using fiscal year 1988 data.

4. No change to report necessary.

5. GAO did not make a recommendation related to this issue.

6. Although FmHA may have corrected some of its accounting system weaknesses reported under the Federal Managers' Financial Integrity Act, the problems we cite in the report continue. Also, an internal FmHA report on its two loan asset sales stated that the sales "revealed areas of weaknesses in FmHA's automated information systems, in the completeness of loan documentation, and in field office reporting." As stated in our report on FmHA's fiscal year 1987 financial statements, the study and evaluation of internal controls in the audit were made for limited purposes and would not necessarily disclose all material weaknesses; consequently, GAO did not express an opinion on FmHA's system of internal accounting controls. However, this report did cite specific weaknesses in FmHA's Automated Multiple Family Housing Accounting System. In a March 1989 letter to OMB on FmHA's use of certain GSA-contracted collection services, the Acting Administrator stated that using such services would require an automated system "with a high degree of accuracy." He further explained that FmHA's current system and procedures would result in too many errors to make its use an effective collection tool. In response to this letter, on April 24, 1989, Treasury stated "FmHA continuously points to the lack of an automated system as

the reason for failing to meet credit management goals." These issues are further discussed in the agency comments section of chapter 4. Also, we have modified the report to more fully explain these issues.

7. Report changed to reflect current status. Also, the regulations were published July 12, 1989, not in August as cited.

8. Revised report.

9. GAO did not make a recommendation related to this issue.

10. The referenced opinion was signed by an Agriculture Associate General Counsel on November 19, 1986.

11. Addressed in agency comments section of chapter 5.

12. GAO did not make a recommendation related to this issue.

13. Addressed in agency comments section of chapter 5 and report revised to reflect the current status.

# Comments From the Department of Education

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

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION

JAN 12 1990

Mr. Donald H. Chapin
Assistant Comptroller General
United States General Accounting Office
Washington, DC 20548

Dear Mr. Chapin:

Thank you for the opportunity to review and comment on the draft GAO report, "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program".

See comment 1.

The GAO report adequately reflects the progress the Department has made over a three year period in implementing OMB's Nine-Point Program. While the Department has not yet fully implemented the Nine-Point Program, efforts are continually being made to develop and implement sound credit management policies.

See comment 2.

The GAO report assesses Federal agencies' implementation of OMB's nine-point credit management program and analyzes changes in the Federal government's loans receivable information between FY 1985 and FY 1988. The report, however, does not reflect the continued progress which has been made since FY 1988 in implementing various points in the Nine-Point Program. An example of this progress can be seen in the area of write-offs.

See comment 3.

The report states that the Department, as well as guaranty agencies, wrote off only a few loans between FY 1985 and FY 1988. However, since FY 1988, policies have been developed and implemented which have resulted in the Department writing-off over $700 million in uncollectible debts in FY 1989 alone.

See comment 4.

Also, the Department's Write-off Policy Working Group developed a draft directive on write-offs which describes the Department's policies, procedures, and requirements for writing off debts. It contains standards for officials to apply in determining what types of debt the Department should write-off and close-out, and when.

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-

Page 2 - Donald H. Chapin

See comment 5.

The directive is currently being circulated throughout the Department for comment and is expected to be issued in final before the end of January, 1990. The Department will continue to fine tune its write-off procedures to insure that uncollectible debt is identified and systematically written off and closed out.

Specific technical comments and our response to the recommendations are enclosed for your information.

Sincerely,

Leonard L. Haynes III
Assistant Secretary

Enclosures

GAO Draft Report Titled, "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program," GAO/AFMD 90-12, Dated December 7, 1989

Technical Comments

GAO Comment: .....agency financial reports sent to Treasury do not separate interest associated with loans from other types of accounts receivables, such as taxes. We were, therefore, unable to quantify the amount of loan interest recorded as accounts receivable. (Pg. 25)

Now on p. 22.

See comment 6.

ED Response: We believe the accounts receivable data on ED's schedule 9's consists entirely of interest receivable.

GAO Comment: .....the longer a debt is outstanding, the more difficult the collection of that debt will be. (Pg. 27)

Now on p. 23.

See comment 7.

ED Response: This statement is not necessarily true for defaulted student loans. Several studies indicate that defaulted student loans become more collectible as they age. We believe this is true because many borrowers default when they are young and have no income or low income. As they mature, we believe they obtain better paying jobs and gain the ability to pay their debts. Concurrently ED's sanctions, such as IRS offset, salary offset, credit bureau reporting and litigation have more meaning to them and they pay their debts.

GAO Comment: Table 2.2 Delinquencies . . .Receivables for the Five Major Credit Agencies. Department of Education Fiscal Year 1985 22.6% and 1988 45.8%. (Pg. 32)

Now on p. 25.

See comment 8.

ED Response: Table 2.2 is extremely misleading. The dramatic rise in the percentage delinquent from fiscal 1985 to fiscal 1988 is primarily due to decrease in receivables (see appendix I, table I.1) from $16.1 billion to $12 billion. To more accurately reflect the portfolio change, the data in table II.1 (appendix II) should be combined with the data in table I.1. This procedure is necessary because virtually all student loans in ED's loans receivable portfolio are in default.

| | FY 1985 | FY 1988 | Source |
|---|---|---|---|
| Guaranteed Loans Receivable | $35.8 B | $47.6 B | Table II.1 |
| Loans receivable | 16.1 B | 12.0 B | Table I.1 |
| | $51.9 B | $59.6 B | |
| Delinquencies | $3.6 B | $5.5 B | Table I.2 |
| % Delinquent | 6.9% | 9.2% | |

This change in the percent delinquent is a 33% increase. It reflects a very serious problem which the Secretary of Education is in the process of addressing with his credit management plan and default initiative. However, because of the structure of the student loan programs and the schedule 9 and 42A reporting requirements, table 2.2 substantially overstates the default problem.

GAO Comment: Education's deteriorating credit condition was primarily due to defaults from the large number of loans made in the late 1970s and early 1980s. (Pg. 40)

Now on p. 30.

See comment 9.

ED Response: The increase in defaults and the increase in the ratio of delinquent loans to loans outstanding can be attributed primarily to increases in loan volume, relatively fewer federal dollars available for grant programs, increases in higher education costs which have outpaced the rate of inflation, and a policy which has targeted Stafford loans to lower middle and lower income individuals. Defaults may also be the result of decreases in the quality of education and the accountability of program participants.

GAO Comment: .....lender activities had decreased steadily from over 800 lender reviews in fiscal year 1981 to fewer than 200 such reviews in fiscal year 1987. (Pg. 67)

Now on p. 49.

See comment 10.

ED Response: The GAO report should mention that in Fiscal Year 1989, ED completed 519 lender reviews. Also, the guaranty agencies conducted about 700 lender reviews during fiscal years 1988 and 1989.

GAO Comment: .....Many delinquent Stafford loan program loans were not referred to IRS for offset. This was because Education did not have sufficient automated resources or collection contractor capabilities to handle referral of such a large number of accounts. (Pg. 78)

Now on p. 58.

See comment 11.

ED Response: This is an incomplete statement. ED generally relied on the guaranty agencies to select accounts to be assigned to ED for IRS offset purposes. Prior to FY 1990, ED did not mandate the assignment of guaranty agency accounts to ED for IRS offset purposes because it did not have the systematic capability and capacity to track these accounts and collect them by other means. Since ED did not have this capability and capacity until FY 1990, it could not meet the legal requirement that mandatory assignment must be in the Federal fiscal interest.

2

ED has increased its capacity to collect these accounts. To the extent that ED can more efficiently collect than guarantors, it intends to exercise its mandatory assignment option when it is in the Federal fiscal interest to do so.

Now on p. 60.

GAO Comment: The agency's decision not to use the GSA contractors will mean that no Education accounts were referred to private collection firms for 1 year. (Pg. 81)

See comment 12.

ED Response: This statement is true only with regard to accounts newly-acquired by ED during 1989, (not paying accounts or not Federal employee accounts) many of which were not referred to collection agencies for approximately one year. During FY 1989 defaulted student loan accounts valued at over one-half billion dollars remained at collection agencies. Sixty ($60) million dollars were collected on these accounts. In the previous paragraph GAO correctly points out that the original (planned) award date for the new collection contracts was February 1989. However, it incorrectly states there was a 1 year gap in referrals "primarily because Education decided to wait until its new automated debt collection system becomes operational".

It should be pointed out that ED contracted with National Computer Systems (NCS) to bring the new debt collection system on-line in April 1989. If NCS had lived up to its contractual agreement and if ED had made collection agency contract awards as planned, accounts could have been referred to the new collection agencies in May 1989.

Conversion to the new debt collection system was delayed several times during the year because of NCS failures.

When it became evident that the new contracts would not be awarded until January 1990, ED debt collection officials appealed to Grants and Contract Services to allow additional account placements to the current ED collection contractors. After a considerable delay the current contracts were modified on November 1989 to allow for additional account transfers - 139,771 accounts valued at $228.6 million. It is estimated that considerably less than one-half of these accounts were newly-acquired in FY 1989. The remainder were accounts returned to ED from collection agencies during 1989.

3

Finally, in addition to the reasons GAO cited for not using the GSA collection contractors, ED would have had to obtain additional resources to monitor the GSA contractors.

Now on p. 63.

GAO Comment: .....In August 1988, Education published regulations to charge a penalty on delinquent debt; however, according to an Education official, the agency will not implement the charge until after the new private collection firm contracts are awarded. (Pg. 86)

See comment 13.

ED Response: This paragraph needs clarification. Under ED's debt collection regulations, as well as under other applicable law, ED may assess penalties only where the promissory note signed by the debtor has a provision which allows the loan holder to assess penalties. (34 CFR 30.61(c), 31 USC 3717(e)(2), 31 USC 3717(g) and 4 CFR 102.13(i) (1)(iii), CFR 102.13(i) 1(iii). The vast majority of student loan promissory notes do not contain such a provision. ED has charged debtors actual collection costs incurred on these loans, and will assess an additional administrative charge of $3 per account per month to defaulters on debts being collected by ED starting in FY 1990. Perhaps this is the additional charge which GAO is referencing in this section of the report.

Now on p. 65.

GAO Comment: Education, as well as the guaranty agencies participating in the Stafford loan program, have written off few loans. This was primarily because Education has not established write-off procedures for guaranty agencies and the Departments' procedures do not comply with OMB Circular A-129. For example, for the accounts assigned from guaranty agencies, Education procedures do not differentiate between written-off and closed-out accounts. Education recently provided guaranty agencies with write-off procedures and is currently revising it internal write-off and close-out procedures. (Pg. 90)

See comment 14.

ED Response: ED and the guarantors have been reluctant to write-off defaulted student loans because data shows that defaulted student loans, unlike other consumer loans, often become more collectible with age.

See comment 15.

In May 1989, ED issued instructions (89-G-159 Attached) to the guarantors covering compromises and write-offs. Guarantors were advised that "....The Secretary intends to require the assignment of all loans on which guarantee agencies cease collection under approved 682.410(b)(4) write-off criteria..." therefore, ED will have the responsibility to close-out these loans after exhausting all collection efforts.

4

See comment 16.

As a matter of policy, ED has decided to write-off all loans which have reached the Federal statute of limitations (six years) and close-out all loans which have reached the period of limitations for administrative offset (ten years). This policy is articulated in a draft directive which we plan to finalize within the next month. It should be noted that this policy will be changed if either the six year or ten year period of limitations changes.

GAO Comment: The agencies in our review have generally not assessed legislatively required interest, penalties, and administrative costs on delinquent debts. The use of these charges would serve as a deterrent to future delinquencies. Also, these charges would generate revenue to the government which would offset at least some of the costs associated with collecting from delinquent debtors. (Pg. 93)

Now on p. 67.

See comment 17.

ED Response: ED has been a leader in this area. ED currently charges defaulters 32.5% of the debt of loans being collected by collection agencies compensated on a contingency fee basis. This year it will also begin assessing an administrative charge of $3 per account per month to cover servicing costs (salaries, space, computers etc.). However, ED officials believe that the government must be concerned that these additional charges do not become a disincentive to repayment. The government must determine the point (or range) where additional charges and penalties become excessive. There is a real financial issue -- at what point do debtors refuse to pay their debts voluntarily, because the burden of the principal, interest, late charges and administrative costs becomes too great? The Department's policy on this subject is under review.

5

Recommendations to the Secretary of the Department of Education

GAO Recommendation: Require program managers or private lenders to modify loan applications to include an applicant's certification that they are or not delinquent on a federal debt (page 59).

Now on p. 42.

See comment 18.

ED Response: We partially agree. We will conduct some analysis of our student loan recipient population to determine the likely effectiveness of implementing the proposal. In conducting this analysis, we will look at the average age of student loan recipients and the probability of them being delinquent on other Federal debts versus the burden implemenation of this proposal would impose on the total student loan population.

GAO Recommendation: Require that program managers and private lenders modify loan applications to include a signed borrower's certification that the borrower has been advised of and understands the government's debt collection practices (page 60).

Now on p. 42.

See comment 19.

ED Response: We disagree. Section 433 of the Higher Education Act of 1965, as amended already requires that numerous disclosures be made to borrowers in either the application or promissory note. Included in those disclosures is a statement outlining the consequences to the borrower if the borrower defaults, including a statement that the defaulter will be reported to a credit bureau or credit reporting agency. Draft regulations which are at OMB for clearance further expands the disclosure requirement to include statements that the borrower will be liable for substantial collection costs that the borrower's Federal and State income tax refund may be withheld to pay the debt, that in certain cases the borrower's wages will be garnished or offset, and that the borrower will be ineligible for additional Federal student financial aid, as well as for assistance under most Federal benefit programs.

GAO Recommendation: Require program managers to implement the procedures set forth in their agencies' regulations, such as regularly scheduled site visits (page 73).

Now on p. 53.

6

See comment 20.

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| ED Response: | We concur. The Department increased its lender review staff to 60 FTE in FY 1989. In FY 1990, these reviewers will conduct over 550 reviews of lender and guaranty agencies. In addition, guaranty agencies will conduct another 500 lender reviews in FY 1990. |
| GAO Recommendation: | Require guaranty agencies to temporarily assign delinquent accounts to Education so that these accounts can be referred by Education to the Internal Revenue Service for federal income tax refund offset (page 94). |
| ED Response: | We concur. Prior to FY 1990, ED did not mandate the assignment of guaranty agency accounts for IRS offset purposes because it did not have the systematic capability and capacity to track these accounts and collect them by other means. Now that we do have the capacity to collect these accounts, the Department intends to exercise its mandatory assignment option when it is in the Federal fiscal interest to do so. |
| GAO Recommendation: | Assess interest, penalties and administrative costs on delinquent debts, pursuant to the Debt Collection Act or other applicable statutes (page 95). |
| ED Response: | ED currently charges defaulters 32.5% of the debt of loans being collected by collection agencies compensated on a contingency fee basis. This year it will also begin assessing an administrative charge of $3 per account per month to cover servicing costs (salaries, space, computers etc.). However, ED officials believe that the government must be concerned that these additional charges do not become a disincentive to repayment. The government must determine the point (or range) where additional charges and penalties become excessive. The Department's policy on this subject is under review. |

Now on p. 68.
See comment 21.
Now on p. 68.
See comment 22.

7

The following are GAO's comments on the Department of Education's letter dated January 12, 1990.

## GAO Comments

1. Addressed in Executive Summary.

2. The report discusses, in chapter 5, Education's efforts to develop write-off procedures.

3. No change to report necessary. See comment 2.

4. See comment 2.

5. Revised report to include target date.

6. No change to report necessary. The information on this refers to the entire federal government. Agency financial reports sent to Treasury do not separate interest associated with loans receivable from other types of accounts receivable.

7. Revised report states that generally the longer a debt is outstanding the more difficult it is to collect.

8. Added footnote to table 2.2 explaining the effect of defaulted guarantees on the percentages. Table 2.2 is to be considered in the context of the entire chapter. We disagree that the data in table II.1 should be combined with the data in table I.1. Education's calculations based on combining these two tables are misleading because they do not include the delinquent loans held by lenders.

9. Clarified report.

10. Added additional information to report.

11. Clarified report.

12. Clarified report to further explain why there was a 1-year gap in referring newly acquired accounts to collection agencies and why Education did not use the GSA contractors. Also revised target date for awarding new contracts.

13. Clarified report to explain that this is an administrative charge.

14. Revised report to include additional reason for not writing off defaulted student loans and to explain Education's recent policy decision regarding write-off and closeout.

15. Education's instructions to guarantors covering compromises and write-offs are not included here but were considered in finalizing this report. They are available from us upon request. Also see comment 2.

16. See comment 14.

17. No change to report necessary. The cited GAO comment is a generalization about the agencies covered in our review. Also, as Education points out in its comments, the vast majority of student promissory notes do not contain a provision which would allow the loan holder to assess such penalties. Further, the report discusses the costs Education assesses delinquent debtors, costs associated with using private collection firms, and the planned administrative charge to cover servicing costs.

18. Discussed in agency comments section of chapter 3.

19. Discussed in agency comments section of chapter 3.

20. Discussed in agency comments section of chapter 4.

21. Discussed in agency comments section of chapter 5.

22. Discussed in agency comments section of chapter 5.

# Comments From the Department of Housing and Urban Development

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

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
THE UNDER SECRETARY
WASHINGTON, D.C. 20410

January 5, 1990

Mr. Donald H. Chapin
Assistant Comptroller General
Government Accounting Office
Washington, DC 20548

Dear Mr. Chapin:

Enclosed please find the Department of Housing and Urban Development's official response to your report to Congress, entitled: "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine Point Program", dated December 1989 (GAO/AFMD-90-12).

If you need any further information about our response, please contact Donna Abbenante of my staff on 755-3532.

Sincerely,

Alfred A. DelliBovi

Alfred A. DelliBovi

Enclosures

**Response to GAO Report On Credit Management**

The Department of Housing and Urban Development has reviewed the captioned report and has the following comments:

1. **Page 59: "We ... recommended that... the Department of Housing and Urban Development ... require that program managers and private lenders obtain loan applicant's consent to obtain tax information from IRS".**

See comment 1.

We agree with the desirability of screening loan applications to deny benefits to those who are delinquent in debts to the IRS. At present, there is no process that provides timely screening of IRS indebtness. Our guaranteed loans are originated in the private sector which is denied access to IRS data. Until a system such as HUD's CAIVRS system is loaded with IRS delinquency data, the time required for screening with the IRS would delay loan processing unacceptably. If the IRS expressed an intent to develop a system for timely screening or agreed to provide debtor data into CAIVRS and if the screening is acceptable under the Computer matching Act of 1988, then HUD will adopt this recommendation. In addition, we would need assurance that the IRS files would exclude taxes that may be in dispute from their delinquency records.

Also, given the importance of Credit Alert as a tool for implementing OMB Circular A-129, it is difficult to understand why OMB itself is delinquent in responding to HUD's April 1989 request for an opinion on the applicability of the Privacy Act to the expansion of Credit Alert.

Section 312 loan applications will be modified to include the applicant's consent for the department to obtain tax information from IRS. It should be noted that the Program Office expressed a concern of revising its loan applications frequently to satisfy GAO's recommendations. It is requested that all necessary changes be consolidated into one recommendation. This would eliminate confusion that occurs in the Field Offices when several requests to modify that application occur at different intervals. Departmental claims would not be included since these debts arise as a result of individuals receiving funds for which they are not entitled. No loan application is involved since the debt is not a result of extending credit.

Now on p. 40.

2. Page 56: -- The second sentence of the first paragraph is incomplete and out-of-date. It should read:

See comment 2.

**"Charges under the Title I manufactured home loan program have not been sufficient to offset claim losses, and in October 1989, HUD revised its method of collecting premiums on these loans in order to correct this problem. More of the premium charge is now collected during the early years of the loan when the risks of default and claim losses are greatest."**

Now on p. 42.

3. Page 60: **"The Secretaries of the Department [including] Housing and Urban Development ... require that program managers and private lenders modify loan applications to include a signed borrower's certification that the borrower has been advised of and understands the Government's debt collection practices".**

See comment 3.

We agree to modify those applications that do not already contain such a certification. Section 312 loans already has this consent on its loan applications. Departmental Claims will not be included for the reason mentioned above. The debtors are informed of the debt collection practices when the demand letters are forwarded.

Now on p. 68.

4. Page 94: **"... Housing and Urban Development ... require program mangers to refer delinquent accounts to private collection firms in the normal course of their collection activities and in accordance with Office of management and Budget Circular A-129."**

See comment 4.

We agree with the recommendation and have referred over $128 million in Title I debts to private collection agencies since 1986. Also, as cited in the report, a single family deficiency judgement pilot is in process, and these judgements will be referred to the Title I concentrated collection centers. These centers attempt to collect and in turn refer problem cases to private collection firms. Multifamily judgements will be referred if appropriate.

On both Section 312 debts and Departmental claims, the Department is currently using the debt collection tools mentioned in the report.

Now on p. 68.

5. **Page 95: "... Housing and Urban Development ... assess interest, penalties and administrative costs on delinquent debts, pursuant to the Debt Collection Act or applicable statutes".**

See comment 5.

We agree. As cited in the Report, we already assess such charges in the single family and multifamily programs and are in the process of amending regulations to charge such assessments in the Title I program.

See comment 6.
Now on p. 63.

In fact, the second sentence at the top of page 87 in the text of this chapter also should be revised to read:

> **"HUD officials informed us that the Department is revising its Title I regulations to permit HUD's administrative cost to be assessed to debtors."**

Now on p. 68.

**Page 95: "The Secretary of Housing and Urban Development ... report closed-out accounts to the IRS as income to the debtor.**

See comment 7.

We report closed-out accounts to the IRS as required. In 1989 (tax year 1988), we reported 949 closed-out Title I accounts totalling $2.7 million. Also, the deficiency judgement initiative will result in a significant increase in single family close-outs that will be reported for tax year 1990 and future years.

See comment 8.
Now on p. 72.

6. Page 98 -- In conclusion we support GAO's recommendation for legislative authority for taxpayer addresses from IRS to be used by other Federal agencies in pursuing the full range of debt collection techniques available to them. We routinely used the services of the IRS to locate debtors in the past under IRS project 719 and are currently revising our agreement with the IRS to comply with the requirements of its Computer Matching Act of 1988. We submitted a proposed agreement to the IRS in late November 1989 and are presently engaged in drafting the required benefit cost analyses and Federal Register

Notice. Presumably, the GAO's recommendation would exclude Project 719 from the requirements of the Computer Matching act and thus reduce the administrative burden to Agencies.

The following are GAO's comments on the Department of Housing and Urban Development's letter dated January 5, 1990.

## GAO Comments

1. Discussed in agency comments section of chapter 3. Further, the Section 312 loan program was not within the scope of our review.

2. Clarified report.

3. Addressed in agency comments section of chapter 3.

4. Addressed in agency comments section of chapter 5.

5. Addressed in agency comments section of chapter 5.

6. Revised report.

7. Addressed in agency comments section of chapter 5.

8. Addressed in agency comments section of chapter 6.

# Comments From the Small Business Administration

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

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

[illegible] -5 1990

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Financial Management Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Chapin:

We have reviewed your draft report entitled, "Credit Management: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program," (GAO/AFMD-90-12).

See comment 1.

Credit management issues have received substantial attention at SBA and we are pleased that GAO notes that SBA has experienced the most favorable changes in credit management in the past 3 years of the 5 major credit agencies reviewed. Furthermore, while we are concerned by the statement on page 4 that SBA understated loan delinquencies in fiscal year 1988 by about $0.2 billion, because we only report past due portions of loans rather than entire loan balances, we are pleased that GAO has acknowledged corrective measures implemented. Notwithstanding, we plan to analyze this aspect of the report further and provide additional comments when the report is issued.

The following are our specific comments on the five recommendations made to SBA in the report:

See comment 2.

Recommendation 1, page 59 - Require that program managers and private lenders obtain loan applicant's consent to obtain tax information from IRS. SBA can add language to require applicants to consent to IRS providing tax information; however, the processes for obtaining such information must be implemented in a manner to allow loan applications to be processed in a reasonable time frame. SBA normally requests that applicants provide copies of tax returns for the last three years as a starting point in the credit analysis process.

See comment 3.
Now on p. 53.

Recommendation 2, page 73 - Require program managers to implement the procedures set forth in their agencies' regulations, such as regularly scheduled site visits. SBA has for years required field office personnel to visit lenders at least annually and conduct portfolio reviews. Our Computerized Internal Control Review (CICR) function, which includes visits to field offices, contains check list items to test compliance with this requirement, or if waived, to assure that waivers are properly justified.

In addition, SBA reviews all requests to purchase guaranteed portions of loans, and may adjust or deny amounts claimed for reasons of lender noncompliance with written agreements or prudent lending practices.

See comment 4.
Now on p. 68.

Recommendation 3, page 94 - Require program managers to refer delinquent accounts to private collection firms in the normal course of their collection activities and in accordance with OMB Circular A-129. SBA views the GSA Debt Collection Services contract as an additional tool to facilitate collection of delinquent debt. SBA maintains an extensive and effective network of field offices that actively pursue delinquent debtors for payment, using automated systems with close management oversight. Field offices are encouraged to refer loans when they are not able to perform the function adequately themselves.

For example, SBA management has identified field offices with high delinquency rates, and during the month of January 1990, will make referrals under the "Cure" portion of the contract of loans 6 months past due but not in active liquidation.

Finally, when field personnel indicate they have pursued all avenues available to them and consider the credit no longer collectible, all loans with no legal bars to further pursuit are automatically referred.

We believe our four years of referral experience, during which the ratio of dollars collected to dollars referred has been less than one percent (1%), enforces the validity of our philosophy of maximum collection efforts prior to referral.

See comment 5.
Now on p. 68.

Recommendation 4, page 95 - Assess interest, penalties and administrative costs on delinquent debts, pursuant to the Debt Collection Act or other applicable statutes. SBA assesses interest on all loans, and in the guaranty portfolio (the largest), the rate assessed is the market rate charged by commercial lenders. Additionally, SBA earns interest from the date of last payment, which, in the case of a delinquent loan, translates into a stiff late payment penalty. Last, in the process of liquidating assets of defunct borrowers, SBA adds all legally allowable expenses incurred in safeguarding and disposing of the assets to the balance of the loans in order to recover those costs wherever possible.

See comment 6.
Now on p. 68.

Recommendation 5, page 95 - Report closed-out accounts to the Internal Revenue Service as income to the debtor. As noted in the draft report, automated systems were developed in fiscal year 1989 that will allow SBA to implement this recommendation in January 1990, and subsequent years.

-2-

In summary, we believe that SBA is in substantial compliance with your draft Recommendations 1 through 4 and that for Recommendation 5, SBA will begin reporting closed-out accounts to IRS in January 1990.

We appreciate the opportunity to comment on the draft report and anticipate providing additional comments on the report when it is issued. If you need any additional information, please contact Mr. Steven A. Switzer, Assistant Inspector General for Auditing at 235-8203.

Sincerely,

Susan

Susan Engeleiter
Administrator

-3-

The following are GAO's comments on the Small Business Administration's letter dated January 5, 1990.

## GAO Comments

1. No change to the report necessary.

2. Discussed in agency comments section of chapter 3.

3. Discussed in agency comments section of chapter 4.

4. Discussed in agency comments section of chapter 5.

5. Report changed to reflect administrative costs charged to debtors. SBA comments related to interest and penalty charges are discussed in the agency comments section of chapter 5.

6. No change to the report necessary.

# Comments From the Department of Veterans Affairs

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

THE SECRETARY OF VETERANS AFFAIRS
WASHINGTON

JAN 1 9 1990

Mr. Donald H. Chapin
Assistant Comptroller General
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Chapin:

I am pleased to respond to your letter, dated December 7, 1989, transmitting your draft report **CREDIT MANAGEMENT: Deteriorating Credit Picture Emphasizes Importance of OMB's Nine-Point Program** (GAO/AFMD-90-12).

Our review of the draft showed three areas of concern that are applicable to the Department of Veterans Affairs (VA). These are:

See comment 1.
- o Loan origination procedures need strengthening;

See comment 2.
- o Account servicing needs continued emphasis, and

See comment 3.
- o Collecting and writing off delinquent debts need more emphasis.

Enclosed is a fact sheet containing our comments to five of the recommendations in the draft report.

See comment 4.

One additional comment concerns your statement that VA suspended reporting closed-out veterans loan guaranty accounts to the Internal Revenue Service (IRS) as income to the debtor. You said this was done because several state law suits challenged the validity of establishing such debts (draft report, page 92). VA's Centralized Accounts Receivable System has never reported these accounts to the IRS as income. There may have been isolated cases where regional offices manually reported a small number of accounts, but the Department has not reported them on an automated basis since we started this program.

Now on p. 66.

Thank you for the opportunity to review and comment on your report.

Sincerely yours,

Edward J. Derwinski
Secretary

Enclosure

Enclosure

**CREDIT MANAGEMENT: Deteriorating Credit Picture**
**Emphasizes Importance of OMB's Nine-Point Program**
(GAO/AFMD-90-12)

**1. Recommendation (page 59) - That the Secretaries of the Departments of Housing and Urban Development and Veterans Affairs, and the Administrators of the Farmers Home Administration and the Small Business Administration require that program managers and private lenders obtain loan applicants' consent to obtain tax information from IRS.**

See comment 5.

Comments - The Veterans Benefits Administration (VBA) has changed its loan guaranty regulations and forms to collect veterans' social security numbers to screen against IRS delinquent taxpayer files. However, because of the long IRS turnaround time, it has not been feasible to screen applicants against IRS files. VBA will explore the option cited on page 48 of the draft report that refers to quicker procedures under 26 U.S.C. 6103(c) for obtaining IRS information.

Now on p. 36.

Now on p. 42.

**2. Recommendation (page 60) - That the Secretary of the Department of Veterans Affairs (for VA's Loan Guaranty program) and the Administrator of Farmers Home Administration (for FmHA's Rural Housing programs) require program managers to deny credit to any loan applicant found to be delinquent on a federal debt, until the debt is satisfactorily resolved.**

See comment 6.

Comments - We agree that applicants who have an outstanding Federal debt will have their applications denied unless they provide evidence that the debt has been paid-in-full or a repayment plan is established. Existing instructions will be revised to this effect.

Now on p. 53.

**3. Recommendation (page 73) - That the Secretary of the Department of Veterans Affairs require program managers to develop and use formal lender agreements which include specific lender requirements and penalties for not achieving these requirements.**

See comment 7.

Comments - We do not consider it necessary to incorporate lender agreements into the loan guaranty program because of the certifications lenders must make on the various forms VA requires. When a lender's certification is breached, VA has the right to adjust or deny a claim in the event of foreclosure. A breach of a lender certification may also result in suspension of the lender. Pending regulations will also allow the assessment of monetary penalties against lenders making false certifications. Other regulations that are now being drafted will clearly state what is

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expected of lenders making loans on the automatic basis (over 80 percent of loans now being guaranteed are automatic loans) with specific criteria for withdrawal of the automatic authority.

Our system is well established and familiar to all participants. Where there are breakdowns, it is not due to a system weakness but rather a deliberate incidence of fraud or a shortage of agency resources, notably personnel, for oversight activities. Any system, either currently in use or proposed, is subject to the same weaknesses. In summary, we see no inherent advantage in requiring a lender agreement vice the currently used certification program.

Now on p. 68.

**4. Recommendation (page 94) - That the Secretaries of Housing and Urban Development and Veterans Affairs and the Administrator of the Small Business Administration require program managers to refer delinquent accounts to private collection firms in the normal course of their collection activities and in accordance with OMB Circular A-129.**

See comment 8.

Comments - VA is referring debts to private collection agencies in our normal course of collection. We discussed with both OMB and Treasury the issue regarding the 6-month timeframe for referral, and they allowed us to use a 1-year timeframe rather than 6 months. This allows us to use credit reporting agencies and IRS income tax refund offset as collection tools before the debt is referred to a private collection agency.

Now on p. 68.

**5. Recommendation (page 95) - The Secretaries of the Departments of Education, Housing and Urban Development, and Veterans Affairs and the Administrators of the Small Business Administration and the Farmers Home Administration (for its Rural Housing loans), assess interest, penalties and administrative costs of delinquent debts, pursuant to the Debt Collection Act or other applicable statutes.**

See comment 9.

Comments - The VBA is already addressing this issue in implementing another GAO audit recommendation included in GAO's final report Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39). We supported legislation for a mortgage indemnity bill that would result in a debt not being created if a loan went into foreclosure. We are currently developing a different approach to the topic of interest charging based on the effect of the new legislation. Our expected completion date is January 31, 1991.

The following are GAO's comments on the Department of Veterans Affairs' letter dated January 19, 1990.

## GAO Comments

1. See comments 5 and 6.

2. See comment 7.

3. See comment 8.

4. Revised report to clarify that this was manual reporting for some accounts.

5. Addressed in agency comments section of chapter 3.

6. Addressed in agency comments section of chapter 3.

7. Addressed in agency comments section of chapter 4.

8. Addressed in agency comments section of chapter 5.

9. Addressed in agency comments section of chapter 5.

# Major Contributors to This Report

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# Glossary

| | |
|---|---|
| Loans Receivable | The unpaid principal of direct loans disbursed by a federal agency and defaulted guaranteed loans. |
| Loan Delinquency | A loan receivable where the borrower has failed to pay the obligation by the date specified in the initial written notification or applicable contractual agreement and has not made other satisfactory payment arrangements. |
| Loan Write-off | A reduction in loans receivable which occurs after an agency determines an amount to be uncollectible. |
| Guaranteed Loans Outstanding | The unpaid total principal of the loan made by private lenders and guaranteed by the government, even though the guarantee may be less than 100 percent of the loan. |
| Termination for Default | Reduction in guaranteed loans outstanding which generally results in agency direct loans or the acquisition of property. |

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