094533

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

FOR RELEASE ON DELIVERY
Expected at ~~9:00 a.m.~~ EDT
Thursday, July 19, 1973

STATEMENT OF
HENRY ESCHWEGE, DIRECTOR, RESOURCES AND ECONOMIC DEVELOPMENT
DIVISION, UNITED STATES GENERAL ACCOUNTING OFFICE
BEFORE THE
SUBCOMMITTEE ON RURAL DEVELOPMENT
OF THE
COMMITTEE ON AGRICULTURE AND FORESTRY
UNITED STATES SENATE
ON
WAYS TO IMPROVE EFFECTIVENESS OF RURAL
BUSINESS LOAN PROGRAMS

Mr. Chairman and Members of the Subcommittee:

We are here today at your request to discuss the Comptroller General's May 1973 report to the Congress on ways to improve the effectiveness of rural business loan programs administered by the Department of Agriculture's Farmers Home Administration (FHA).

Under section 118 of the Rural Development Act of 1972, FHA is authorized to make, insure, or guarantee loans for improving, developing, or financing business, industry, and employment in rural communities. These loans may be made available to public, private, or cooperative organizations. Sections 102 and 121 of the act also authorize FHA to make or insure loans to rural residents acquiring, establishing, or operating small business enterprises in rural areas.

Although the review on which our report was based dealt with FHA's administration of the now discontinued Economic Opportunity Cooperative

Loan Program--a program which was limited to business cooperatives whose members were predominantly low-income rural families--we believe that the basic management procedures and criteria we covered in the review are essential for effective administration of rural business loan programs in general. Therefore our findings hopefully will be useful to FHA in administering the new business loan programs and to this Subcommittee in carrying out its responsibilities related to the revitalization of rural areas and to the implementation of Federal rural development programs.

The new business loan programs authorized by the Rural Development Act are much more encompassing than the old cooperative loan program and give the FHA much more responsibility than it previously had for assisting business-type enterprises.

If these enterprises are to have a reasonable chance to succeed, FHA will have to assure itself that they are conceived and operated on a sound business basis, that its guidelines and requirements will be adequate to help achieve this objective, and that it has a sufficient staff of experienced or trained employees to properly implement the guidelines and supervise the activities of loan recipients.

The principal purpose of the earlier cooperative loan program, which was authorized by the Economic Opportunity Act of 1964, as amended, was to assist low-income persons in cooperative associations improve their economic condition. Loans were available to cooperative associations which furnished needed processing, purchasing, or marketing services, supplies, or facilities to their members.

Responsibility for administering the program was delegated to the Secretary of Agriculture by the Director of the Office of Economic Opportunity (OEO) and was redelegated by the Secretary to FHA.

From the program's inception through June 30, 1971, when OEO and the Office of Management and Budget decided to discontinue it, FHA made 1,455 loans totaling about $20.9 million to 1,315 cooperative associations. As of January 1, 1973, FHA was still servicing the loans for 585 of these cooperatives.

Our review consisted primarily of examining FHA's policies, procedures, and practices relating to the program; obtaining information from FHA's State offices on cooperatives which were no longer active or which were being liquidated; reviewing reports issued by other agencies in the Department on their reviews of the cooperative loan and other FHA programs; and examining, in detail, the activities of 10 large active cooperatives located in 7 States.

These 10 cooperatives had each received from $50,000 to $251,500 in loan funds under the program for a total of about $1.2 million. As of January 1, 1973, five of them were delinquent in their loan repayments and two had been liquidated but still owed part of their loans.

The information we obtained from FHA's State offices showed that many of the cooperatives assisted under the program had problems and failed to stay in business or became delinquent in their loan repayments. These problems included, among others, weak management, lack of member participation, and adverse market conditions.

Our review at the 10 cooperatives showed that they had experienced some of the same problems. Although not all the problems could have been foreseen, we concluded that many of them could have been anticipated and prevented, had FHA required adequate determinations, before loan approval, of the economic soundness and feasibility of cooperative projects and had FHA adequately supervised and evaluated the cooperatives' activities.

NEED TO REQUIRE FEASIBILITY STUDIES AND MARKETING AGREEMENTS

Under its pre-approval procedures, FHA did not require feasibility studies to be made before loans were approved. Nor did the procedures identify what factors FHA employees were to consider in providing guidance to the cooperatives in developing economically sound and feasible projects. In the case of marketing cooperatives, FHA did not require that cooperative members enter into agreements to deliver specified portions of their production to the cooperatives, nor did it require that the cooperatives enter into marketing agreements with processors and distributors.

Marketing agreements are important in insuring that a cooperative has sufficient control over the products to be delivered and marketed so that it can function properly. They are especially helpful in the first few years of operation while the cooperative is trying to establish its reputation as a going, responsible, and successful business.

Aside from our own study, a Farmer Cooperative Service study of 48 cooperatives that had received loans under the program showed that nearly all the loans were made without feasibility studies; that most members of marketing cooperatives had no marketing agreements with their cooperatives;

and that many marketing cooperatives had no marketing agreements with processors and distributors. The Service's report stressed the importance of feasibility studies and marketing agreements to the success of cooperative businesses.

NEED TO REQUIRE COMPETENT MANAGEMENT OF THE BUSINESS ENTERPRISE

Another important factor in the success of a business is its management. FHA instructions, however, did not require its employees to encourage cooperatives to obtain competent managers. Also, FHA employees did not always seek to obtain needed training for cooperative management employees although the instructions called for them to do so.

Several of the 10 cooperatives we reviewed were managed by persons with limited business education and business experience. In some cases, FHA recognized the need for these persons to receive training but such training had not been provided. The Farmer Cooperative Service study showed that few educational training programs had been developed for cooperative members although there was a definite need for such programs.

NEED FOR ADEQUATE ACCOUNTING, FINANCIAL REPORTING, AND AUDITING

We also found that the 10 cooperatives in our review had not always complied with FHA's instructions concerning accounting records, financial reports, and annual audits and that FHA employees, who were to give special attention to these matters, had not always done so. The deficiencies we noted included (1) maintenance of checkbooks as the only accounting records, (2) lack of independent audits and bank reconciliations, (3) lack of financial reports on cooperative operations, and (4) improper classifications of financial data.

Accurate and timely financial and operating information is needed to provide a basis for essential management decisions; to keep members and users informed about the cooperative's operations; and to provide FHA with periodic information that indicates trends and reflects where guidance and supervision may be needed.

Also in the financial area, the Farmer Cooperative Service reported that the amounts of loan funds designated for operating needs in the development stages of the cooperatives it studied, seemed much lower than the amounts needed by the average cooperative. The Service said that adequate operating capital--for such needs as hiring qualified staff, purchasing supplies, and paying members upon delivery of products to be marketed--was a critical factor in the success of new cooperatives and that adequate loan funds should be designated for operating capital.

NEED TO PROVIDE ADEQUATE SUPERVISION

In regard to supervision, we found that FHA employees at State, district, and county offices responsible for supervising the 10 cooperatives often lacked the time, training, or experience needed to effectively supervise cooperative activities. They told us that they had received little or no training in identifying, analyzing, or resolving cooperative problems, and many of them said they did not have sufficient time to supervise large cooperatives.

Some FHA officials attributed the time problem to the fact that FHA's workload had expanded greatly during the 1960's without appropriate increases in staffing. One estimate by FHA's former Administrator was that, from 1960 to 1971, the number of FHA loans and grants under all programs had increased 624 percent while staffing increased 77 percent. An FHA official at one State office told us that the increased workload had resulted in emphasizing loan-making rather than loan-servicing.

The Farmer Cooperative Service reported that, in most instances, the supervision of the cooperatives it studied had been sufficient to protect the best interests of the cooperatives and the Government but that, if more properly trained personnel had been available for supervision of cooperatives, particularly before loans were made, the delinquency record would have been more favorable.

An August 1971 report by the Department's Office of the Inspector General on its review of various FHA loan programs said that the primary thrust of FHA activities in recent years had been on loan-making, to the detriment of supervision and loan-servicing. The report said also that FHA needed to strengthen its staff both in numbers and technical skills to keep pace with the expansion and complexity of its programs.

NEED TO ESTABLISH SPECIFIC PROGRAM AND PROJECT GOALS

The final point we made in our report was that FHA had not established specific program and project goals for measuring whether cooperative loans were effective in achieving the program's objective of raising and maintaining the income and standard of living of low-income rural families. As a result, there was no criteria against which to judge whether benefits received by individual members, and the number of members receiving them, met, fell short of, or exceeded expectations.

We believe that measuring and evaluating progress in meeting specific goals can pinpoint shortcomings and show where corrective action and technical or other assistance is needed.

RECOMMENDATIONS

Because our findings related to basic management procedures and criteria applicable to rural business loan programs in general, we recommended to the Secretary of Agriculture that, in implementing the Rural Development Act of 1972:

--FHA develop guidelines and instructions which will require that, before loans are approved, appropriate provision be made for project feasibility studies; marketing agreements; competent management and necessary training; and sufficient funds for operating capital.

--FHA take such action as is necessary to insure that it has a sufficient staff of experienced or trained employees to properly implement the guidelines and instructions and to properly supervise the activities of loan recipients.

--And that FHA express program objectives in terms of specific goals, when practical, and use such goals to measure program effectiveness periodically.

AGENCY COMMENTS AND STATUS OF ACTIONS TO IMPLEMENT OUR RECOMMENDATIONS

In commenting on a draft of our report in December 1972, the Department expressed complete agreement that regulations for implementing the 1972 act should contain guidelines on feasibility studies, marketing agreements, competent borrower management, and funds for operating capital. It stated that FHA had taken some steps to provide effective training for its employees and had considered the need for additional staffing of new types of professional and technical skills. The Department stated also that, when practical, FHA would express program objectives in specific goals and use such goals to periodically measure program effectiveness.

In June 1973, after our report was issued, the Department furnished a statement on actions taken on our recommendations to the Senate and House Committees on Government Operations and the Office of Management and Budget (OMB). The statement advised that FHA had drafted regulations requiring all applications for loan assistance to include appropriate feasibility studies, marketing agreements, management evaluations, and a detailed analysis of the adequacy of working capital. The regulations would also require the FHA State Director to perform a feasibility analysis of the project prior to insuring or guaranteeing any loan.

The proposed regulations were placed in the Federal Register on June 22, 1973, at which time public comments were invited.

In its June 1973 statement to the committees and OMB, the Department said also that FHA planned to augment its headquarters and State office staffs to assure that they had the experience or training to properly implement the regulations and supervise the activities of loan recipients. An FHA official told us on July 10, 1973:

--That FHA was selecting one staff member in each State office to receive formal training and that such selections had already been made for all but 12 State offices.

--That the first training session for those selected was scheduled for August 1973 with four more training sessions scheduled on a monthly basis from November 1973 through February 1974.

--And that FHA planned to add several loan specialists to its headquarters staff and to assign an evaluation team to work with the specialists and review the feasibility of loans during the first year.

With respect to establishing program goals, the Department told the committees and OMB that the initial period of business and industrial loan activity would be at a modest level to allow FHA to develop, implement, and evaluate program procedures and that specific program goals would be evaluated as experience was gained in fiscal year 1974.

Mr. Chairman, this concludes my statement. We will be glad to respond to any questions.