

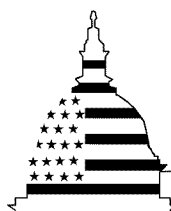
GAO

Report to the Chairman, Subcommittee
on Government Efficiency, Financial
Management and Intergovernmental
Relations, Committee on Government
Reform, House of Representatives

February 2002

DEBT COLLECTION IMPROVEMENT ACT OF 1996

Department of
Agriculture's Rural
Housing Service Has
Not Yet Fully
Implemented Certain
Key Provisions



G A O

Accountability * Integrity * Reliability

Report Documentation Page

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Abstract The purpose of this report is to expand on the information provided in our December 2001 testimony regarding RHS's progress and to offer our recommendations for improving the agency's implementation of the debtreferral provisions of DCIA. As you know, our prior reports have shown that agencies have been slow to implement the referral requirements of DCIA. ³ Our testimonies referred to above offered an overview of agencies progress during fiscal year 2000 and fiscal year 2001 to the extent that data were available and addressed your request for information. For this report, we looked at whether (1) RHS was promptly referring eligible single-family housing (SFH) loans to Treasury's FMS for collection action, (2) any obstacles were hampering RHS from referring eligible SFH loans to FMS, and (3) RHS was appropriately using exclusions from referral requirements.		
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United States General Accounting Office
Washington, D.C. 20548

February 28, 2002

The Honorable Stephen Horn
Chairman
Subcommittee on Government Efficiency,
Financial Management and Intergovernmental Relations
Committee on Government Reform
House of Representatives

Dear Mr. Chairman:

On October 10, 2001, we testified before your subcommittee on selected federal agencies' implementation of certain key provisions of the Debt Collection Improvement Act (DCIA) of 1996.¹ That testimony addressed requirements to refer older delinquent debt to the Department of the Treasury for offset against amounts the government might owe the debtors and for additional collection action at Treasury's central debt-collection facility, operated by the Financial Management Service (FMS). Our more recent testimony, in early December 2001, focused on progress in this area by two Department of Agriculture agencies—the Rural Housing Service (RHS) and the Farm Service Agency (FSA).²

One of the major purposes of DCIA is to maximize collection of billions of dollars of nontax delinquent debt owed to the federal government. Toward this end, DCIA requires that agencies refer eligible debts delinquent more than 180 days that they have been unable to collect to Treasury for payment offset and to Treasury or a Treasury-designated debt collection center for cross-servicing. Treasury performs payment offset through its Treasury Offset Program (TOP), which includes the offset of certain benefit payments, vendor payments, and tax refunds. Cross-servicing involves such actions as locating debtors, issuing demand letters, and referring debts to private collection agencies.

¹U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Agencies Face Challenges Implementing Certain Key Provisions*, GAO-02-61T (Washington, D.C.: Oct. 10, 2001).

²U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture Faces Challenges Implementing Certain Key Provisions*, GAO-02-277T (Washington, D.C.: Dec. 5, 2001).

The purpose of this report is to expand on the information provided in our December 2001 testimony regarding RHS's progress and to offer our recommendations for improving the agency's implementation of the debt-referral provisions of DCIA. As you know, our prior reports have shown that agencies have been slow to implement the referral requirements of DCIA.³ Our testimonies referred to above offered an overview of agencies' progress during fiscal year 2000 and fiscal year 2001 to the extent that data were available and addressed your request for information. For this report, we looked at whether (1) RHS was promptly referring eligible single-family housing (SFH) loans to Treasury's FMS for collection action, (2) any obstacles were hampering RHS from referring eligible SFH loans to FMS, and (3) RHS was appropriately using exclusions from referral requirements.

Results in Brief

RHS has ongoing initiatives to enhance its capacity to timely refer all delinquent debt. However, the agency's failure to make DCIA a priority since its enactment in 1996 has left key provisions of the act not yet implemented and severely reduced opportunities for collection as contemplated by DCIA. As of September 30, 2000, RHS reported that it had referred about \$201 million of delinquent direct SFH loans to TOP for offset. The agency had referred virtually no direct SFH loans to FMS for cross-servicing, however.

We identified three major factors that were delaying implementation of an effective and complete debt-referral process. First, RHS's loan-servicing system had not been modified to incorporate certain key features needed to effectively implement the referral provisions in DCIA. Because of these limitations, the system could not identify eligible loans for referral for cross-servicing. Second, RHS did not refer any debts for cross-servicing while pursuing an exemption from Treasury. Although Treasury discouraged the exemption request and ultimately rejected it, RHS referred no delinquent direct SFH loans for cross-servicing for the extended period during which Treasury considered the request. Third, our work showed that amounts reported as delinquent and therefore eligible for consideration for referral were materially understated. In particular, RHS

³U.S. General Accounting Office, *Debt Collection: Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative*, GAO/AIMD-00-234 (Washington, D.C.: Aug. 4, 2000), and U.S. General Accounting Office, *Medicare: HCFA Could Do More to Identify and Collect Overpayments*, GAO/HEHS/AIMD-00-304 (Washington, D.C.: Sept. 7, 2000).

had included only the delinquent installment portion of direct SFH loans on reports to Treasury rather than the entire loan balance, which under RHS policy becomes due and payable when an installment payment on a direct SFH loan is delinquent more than 90 days. RHS also had not taken steps to recognize the losses that it paid on SFH loans to guaranteed lenders as federal debt and could not apply DCIA debt collection remedies to them.

Regarding the accuracy of delinquent loan balances excluded from referral, RHS had not retained the necessary documentation to enable independent verification of the accuracy and validity of the exclusion amounts in RHS's certified fiscal year 2000 year-end report. Accordingly, we were unable to determine whether RHS had appropriately excluded about \$182 million of delinquent SFH loans from referral for offset through TOP and for cross-servicing as of September 2000.

We are recommending that RHS take several actions to enhance the scope and improve the timeliness of referrals of delinquent debt under DCIA.

Agriculture's Rural Development mission area, which includes RHS, stated in its comments on the report that RHS had implemented or was in the process of implementing three of the four recommendations in this report. Rural Development disagreed with our recommendation to report the entire accelerated balance of delinquent direct SFH loans to FMS as delinquent debt, and, absent any allowable exclusions, as debt eligible for referral to FMS for collection action. In support of its position, Rural Development stated that the inclusion of only the delinquent portion of collateralized installment loans is consistent with industry standards and reporting the entire amount accelerated would not represent the amount legally collectible, and would distort actual risk. Rural Development's response is not consistent with either RHS's own governing debt collection policy and practices or Treasury's instructions to federal agencies for reporting accelerated debt balances on the Treasury Report on Receivables Due from the Public (TROR).

Background

RHS is a component of Rural Development, a mission area within Agriculture that was created when the department was reorganized in 1994. RHS provides a wide array of housing services to rural residents and often offers more favorable loan terms and conditions than other federal housing programs. The agency delivers services through an extensive network of field offices. In September 1997, Rural Development completed a conversion of its direct SFH loan servicing from a dispersed nationwide

network of more than 2,000 field offices to Agriculture's new Central Servicing Center. The center is responsible for servicing the department's entire direct SFH loan portfolio, which totaled about \$17 billion at the close of fiscal year 2000.

Through its SFH programs, RHS provides highly subsidized direct loans to rural households with very low and low incomes, guaranteed loans to households with low and moderate incomes, and grants and direct loans for housing repairs to households with very low incomes.⁴ Under the guaranteed SFH loan program, RHS agrees to reimburse approved private lenders for up to 90 percent of the principal advanced to a borrower in the event the borrower defaults. In recent years, RHS's guaranteed SFH loan program has expanded, with the reported outstanding principal due on the guaranteed SFH loan portfolio increasing from about \$3 billion in fiscal year 1996 to more than \$10 billion at the end of fiscal year 2000.

Objectives, Scope, and Methodology

Our objectives were to determine whether (1) RHS was promptly referring eligible SFH loans to FMS for collection action, (2) any obstacles were hampering RHS from referring eligible SFH loans to FMS, and (3) RHS was appropriately using exclusions from referral requirements.

To determine whether RHS is promptly referring eligible SFH loans to FMS for collection action, we interviewed officials responsible for identifying eligible SFH loans and referring them to FMS. We also reviewed pertinent policies, procedures, and reports related to RHS loan referrals, including Treasury instructions for preparing the TROR and RHS internal delinquency reports. To determine whether any obstacles were hampering RHS from referring eligible SFH loans, we interviewed RHS officials and obtained and reviewed relevant documents, including the agency's debt-referral schedule and Agriculture's request to Treasury to exempt delinquent SFH loans from referral for cross-servicing for up to a year after liquidation of collateral. We also reviewed responses to questions about RHS's debt collection practices that you submitted to the deputy secretary of agriculture in October 2001. We used information from the responses to clarify or augment our report, where appropriate.

⁴Very-low-income households have incomes at or below 50 percent of their area's median income; low-income households have incomes above 50 percent and at or below 80 percent of their area's median income; and moderate-income households have incomes above 80 percent and at or below 115 percent of their area's median income.

A scope limitation prevented us from determining whether RHS's exclusions of about \$182 million of direct SFH loans from referral requirements were appropriate. RHS officials told us that the agency did not retain supporting documentation (a list of individual loans, including loan amounts, for each exclusion category) for the \$182 million of direct SFH loans excluded from referral to FMS. Without such documentation, we could not independently verify that amounts excluded for forbearance or appeals, bankruptcy, and foreclosure were accurate or met established criteria.

We conducted our review from November 2000 through October 2001 in accordance with U.S. generally accepted government auditing standards. We did not independently verify the reliability of certain information that RHS provided to us (e.g., debts more than 180 days delinquent and debts classified as currently not collectible (CNC)⁵ and information in RHS's loan-accounting and loan-servicing systems).

We requested written comments on a draft of this report from the secretary of agriculture or her designated representative. Rural Development provided Agriculture's response and Rural Development's letter is reprinted in appendix I.

RHS Has Referred a Minimal Amount of Delinquent Direct SFH Loans for Cross-Servicing

Since the passage of DCIA in April 1996, RHS has referred a minimal amount of direct SFH loans to FMS for cross-servicing. As of September 30, 2000, RHS reported about \$383 million of direct SFH loans delinquent more than 180 days. Because of a software deficiency that prevented automated identification of direct SFH loans eligible for cross-servicing and an agency plan to obtain an exemption from referring direct SFH loans for cross-servicing, RHS had referred virtually no delinquent SFH loans for cross-servicing as of September 30, 2000. However, as of the same date, RHS reported having referred about \$201 million of direct SFH loans to FMS for TOP.

⁵CNC debts are debts the agency has written off for accounting purposes but has not discharged. Collection action can still be taken on such debts.

Table 1: RHS's Direct SFH Loans Delinquent as of September 30, 2000

	Loan amounts (in millions of dollars)
Loans more than 180 days delinquent, including loans classified as currently not collectible (CNC)	\$383
Less: exclusions allowed by DCIA ^a	182
Loans eligible for TOP	201
Loans referred to FMS for TOP	201
Loans referred to FMS for cross-servicing	0

^aExclusions were for bankruptcy, forbearance/appeals, and foreclosure.

Source: Treasury Report on Receivables Due from the Public for fourth quarter 2000 (September 30, 2000).

Beginning in April 2001, RHS began manually referring a small number of direct SFH loans—approximately 100 a month—to FMS for cross-servicing. However, this effort, discussed in more detail later in this report, is an extremely limited measure and results in referrals of only a small fraction of the agency's eligible delinquent SFH loans.

Several Obstacles Have Impeded RHS's Implementation of DCIA Referral Requirements

Since DCIA's enactment, several obstacles have seriously impeded RHS's implementation of the act's referral requirements. Because of a software deficiency that has existed since fiscal year 1997, Agriculture's automated loan-servicing system cannot identify loans that are eligible and should be referred for cross-servicing. As a result, RHS referred virtually no direct SFH loans to FMS for cross-servicing through September 30, 2000, and only minor amounts through September 30, 2001. An additional obstacle was RHS's application for—and unrealistic expectation of receiving—an exemption from Treasury that would have allowed the agency to delay referring direct SFH loans to FMS for cross-servicing for up to a year after liquidation of a loan's collateral. Based on its expectation that the exemption request would be approved on an after-the-fact basis, RHS classified all of its delinquent direct SFH loans as excluded from referral requirements in its September 30, 2000, TROR. Finally, RHS understated loan amounts that are eligible for referral in two respects. First, the agency included in its reporting of delinquent debts only the delinquent portions of installment loans rather than the total unpaid loan balances as required by Treasury. Second, RHS did not take action until recently to recognize losses on guaranteed SFH loans as nontax federal debt. Until these steps

are completed, RHS cannot use the collection tools provided under DCIA to pursue collection directly from debtors on guaranteed SFH loans.

System Limitations Hampered Identification and Referral of Loans for Cross-Servicing

During fiscal years 1996 and 1997, RHS converted its loan-servicing system, which serviced a portfolio of more than 700,000 direct SFH loans, from a decentralized servicing network of more than 2,000 field offices to a single, automated loan-servicing location—Agriculture’s Central Servicing Center. The main automated system is a commercial off-the-shelf loan-servicing system that required modification if it was to perform the unique functions associated with the direct SFH loan program, such as identifying direct SFH loans eligible for cross-servicing. If the system is to perform this function, it must, for example, be capable of determining the status of any collateral, because all collateral must be liquidated prior to a loan’s referral to FMS for cross-servicing. According to RHS officials, RHS has been unable since the conversion to readily identify direct SFH loans that are eligible for referral to FMS for cross-servicing because the necessary software was not completed prior to conversion. RHS nevertheless completed the conversion in fiscal year 1997 because the agency did not want to delay implementation of the new system. RHS plans to complete the system software in April 2002 and has stated that the software modifications will facilitate identification of loans for cross-servicing.

In April 2001, while we were performing our fieldwork, RHS began an interim process to manually identify direct SFH loans eligible for cross-servicing. Agency officials advised us, however, that relatively few referrals for cross-servicing are likely to be made before completion of the software because the interim manual process is tedious and labor-intensive. According to RHS’s debt-referral schedule, only about 100 to 200 loans are to be referred each month, and as of September 30, 2001, the agency had referred 599 direct SFH loans to FMS for cross-servicing. The current manual process creates an overwhelming challenge for the agency because of the large volume of loans potentially eligible for cross-servicing. RHS officials said that all direct SFH loans eligible for TOP will have to be reviewed for cross-servicing eligibility. As of September 30, 2000, RHS had referred 23,032 direct SFH loans to FMS for TOP. According to RHS’s debt-referral plan as of the completion of our fieldwork, the agency intends to refer about 30 percent of eligible direct SFH loans to FMS for cross-servicing in fiscal year 2002. The 30 percent referral level takes into account the increased rate of referrals RHS expects will result from the planned April 2002 completion of loan-servicing software that will permit automated identification of direct SFH loans eligible for cross-servicing.

RHS Delayed Direct SFH Loan Referrals while Seeking an Exemption

RHS made no attempts prior to April 2001 to manually identify and refer direct SFH loans eligible for cross-servicing. According to agency officials, RHS did not attempt manual identification because the agency was in the process of requesting an exemption from Treasury that would allow it to service direct and guaranteed SFH loans internally for up to 1 year after liquidation of collateral. Liquidation could, in some cases, occur years after a loan became delinquent.

Treasury officials told us that the department had informal discussions with Agriculture officials concerning the planned request. They said Treasury discouraged Agriculture from submitting a formal request because Treasury did not believe an exemption was warranted. Nevertheless, Agriculture submitted a formal request for an exemption on behalf of RHS in November 2000. Although Treasury officials stated that the department had never formally or informally approved the request, RHS reported in its September 30, 2000, TROR that Treasury had approved the request. In the TROR, RHS classified all eligible direct SFH loans as exempted by Treasury from cross-servicing.

Treasury issued a formal denial of the exemption request on May 14, 2001. The denial was based in part on the fact that other agencies with similar delinquent loans were referring the loans for cross-servicing and that RHS had not identified any new or unique collection tools applicable to its SFH loans that would justify different treatment. RHS officials said that they contacted Treasury in January 2001 to acknowledge that the statement regarding the approval of the exemption request in the September 30, 2000, TROR was incorrect. However, in subsequent quarterly TROR submissions through June 30, 2001, RHS continued to report significant direct SFH loan amounts as exempted by Treasury from cross-servicing.

RHS Did Not Consider the Full Range of Debt for DCIA

RHS did not consider the full range of debt that should have been subject to DCIA referral requirements in two important areas. First, RHS reported as delinquent debt only the delinquent portion of installment loans rather than the total unpaid loan balances. Second, RHS did not take the necessary steps to recognize losses on guaranteed SFH loans as nontax federal debt and therefore did not report them and could not attempt to collect on them using tools authorized by DCIA.

RHS Did Not Report Accelerated
Loan Balances as Delinquent
Debt

When a direct SFH installment loan becomes more than 90 days delinquent, RHS notifies the debtor by certified mail that the entire loan balance is accelerated and that the full outstanding loan balance is due and payable. The notice also stipulates RHS's intent to foreclose on the loan unless the agency receives full payment of the indebtedness within 30 days of the date of the letter. According to instructions for preparing the TROR that Treasury provided to all agencies subject to DCIA requirements, the entire amount of the debt is to be recorded as delinquent if any part of it has been delinquent more than 180 days, provided the debtor has been notified that the entire amount is due (or accelerated). Absent any exclusions allowed by DCIA or Treasury, Treasury's instructions call for agencies to report the entire unpaid loan amount as eligible for referral for collection action.

However, RHS reports only the delinquent installment portion of the loans as delinquent in its TROR and does not report the accelerated loan balances as delinquent debt. Similarly, RHS reports only the delinquent installment portion as eligible for referral to TOP. RHS officials said they do not believe it is appropriate to refer more than the delinquent portion of direct SFH loans to FMS. They said they are concerned that if RHS referred amounts greater than the delinquent installments before liquidation of collateral at foreclosure, the agency would risk collecting amounts in excess of those due from borrowers. This situation should not arise, however, because DCIA allows any debt to be temporarily excluded from referral if its collateral is being liquidated as part of foreclosure proceedings. Therefore, under its practices and Treasury's requirements, RHS should report all amounts due and payable and refer them to FMS for collection action unless the loans are in foreclosure or meet other exclusion criteria.

As previously stated, at the end of fiscal year 2000, RHS reported that about \$383 million of direct SFH loans were more than 180 days delinquent and that approximately \$201 million of the loans were eligible for and had been referred for offset through TOP. Based on our review of RHS's internal delinquency records, by not including accelerated loan balances RHS may have understated delinquent direct SFH loan amounts reported to Treasury by about \$849 million and direct SFH loan amounts eligible for offset through TOP by about \$348 million. Underreporting delinquencies distorts the TROR for debt management and credit policy purposes. It also distorts key governmentwide financial indicators, including total delinquencies outstanding, on which the president, the Congress, and the Office of Management and Budget rely to make important budget and management decisions. In addition, by underreporting direct SFH loan amounts eligible

for referral for offset through TOP, RHS is forgoing opportunities to maximize the collection of delinquent debt.

RHS Did Not Refer Losses on Guaranteed SFH Loans to Treasury for Collection

Guaranteed SFH loans—as well as related losses—have been significant since the enactment of DCIA in 1996. In recent years, the program has expanded, with the reported outstanding principal due on the guaranteed SFH loan portfolio increasing from about \$3 billion in fiscal year 1996 to more than \$10 billion at the end of fiscal year 2000. The reported amount paid out in losses over the same period rose from about \$3.2 million in fiscal year 1996 to about \$60.5 million in fiscal year 2000.

Since DCIA was enacted in 1996, none of the approximately \$132 million in such losses on RHS's guaranteed SFH loan program have been referred to FMS for collection action. According to RHS officials, the agency could not pursue recovery from the debtor or utilize DCIA debt-collection tools because under the SFH guaranteed loan program, no contract existed between the debtor and RHS. As a result, the agency did not recognize the losses that it paid to guaranteed lenders as federal debt and could not apply DCIA debt-collection remedies to them.

In January 1999, Agriculture's Office of Inspector General (OIG) reported that RHS was not referring its losses on guaranteed SFH loans to FMS for collection. At that time, the OIG identified the need for RHS to recognize the losses as federal debts and begin referring them to FMS for collection. However, as of September 30, 2000, RHS still had no policies and procedures to recognize losses on guaranteed SFH loans as federal debts and to refer such debts to FMS for TOP and cross-servicing. As a result, RHS has missed opportunities to collect millions of dollars the agency has paid to lenders to cover guaranteed losses.

RHS officials told us that the agency is now working with Agriculture's Office of General Counsel and OIG to amend program regulations and has recently initiated action to develop policies for future referral of losses on guaranteed SFH loans to FMS for collection action. However, RHS's efforts to make necessary regulatory changes and modifications to lender agreements are still under way and have yet to be implemented. Therefore, RHS continues to miss opportunities to collect from borrowers the amounts it has paid to cover losses on guaranteed SFH loans. Because the size of the guaranteed SFH loan program and related losses are significant and growing, it is critical that RHS promptly complete development and begin implementation of policies and procedures to refer eligible guaranteed SFH loan debts to FMS for collection action.

RHS Did Not Maintain Documentary Support for Excluding Delinquent Debts

DCIA permits debts to be excluded from referral for cross-servicing and offset if they are in forbearance, under appeal, in litigation at the Department of Justice, in bankruptcy, or in foreclosure. In August 2000, we reported that governmentwide, agencies were excluding from referral the vast majority of debts reported delinquent more than 180 days under DCIA or Treasury exclusion criteria. We cautioned that the reliability of the amounts reported as excluded needed to be independently verified on a periodic basis.⁶

FMS officials said that they expect agencies to retain applicable information to justify exclusions of debt from referral. In addition, the Comptroller General's *Standards for Internal Controls in the Federal Government* states that all transactions and other significant events need to be clearly documented and that the documentation should be readily available for examination.⁷

When we attempted to verify RHS's reported exclusions from referral as of September 30, 2000, RHS officials told us that supporting documentation (a list of individual loans and loan amounts that were excluded in each exclusion category) for the \$182 million of direct SFH loans excluded from referral for offset through TOP had not been saved. In addition, the chief of the financial accounting branch said she was not aware of any requirement to retain such data. Because we had no information on which individual loans had been excluded, we were unable to determine whether the agency's reported exclusions for bankruptcy, forbearance/appeals, and foreclosure met relevant legislative and regulatory criteria.

Conclusions

Through its failure to comply fully with DCIA debt collection requirements, RHS continues to miss opportunities to maximize collection on delinquent SFH loans. Although more than 5 years have passed since DCIA's enactment, RHS has referred a minimal amount of its direct SFH loans for cross-servicing and has yet to refer any losses on its growing guaranteed SFH loan program. RHS has identified and referred direct SFH loans eligible for TOP but significantly understated loan amounts eligible for

⁶GAO/AIMD-00-234.

⁷U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: Nov. 1999), p. 15.

referral by not including accelerated direct SFH loan balances. RHS also did not take the steps necessary to recognize losses on guaranteed SFH loans as federal debt subject to the provisions of DCIA. In addition, RHS's failure to retain a listing of specific loans and loan amounts excluded from referral for offset through TOP effectively eliminates the possibility of independent verification of excluded debt—a critical internal control technique.

Recommendations for Executive Action

To improve RHS's compliance with DCIA, we recommend that the secretary of agriculture direct the administrator of RHS to take the following actions:

- Work together with FMS to resolve any inconsistencies between RHS's reporting of delinquent debts on its TROR and Treasury's instructions for such reporting. Absent any modifications to Treasury's instructions for preparing the TROR, report the entire accelerated balance of delinquent direct SFH loans to FMS as delinquent debt and, absent any allowable exclusions, as debt eligible for referral to FMS for collection action.
- Finalize and implement necessary regulatory changes and modifications to lender agreements to recognize losses on guaranteed SFH loans as federal debt and promptly refer such debt to FMS for collection action.
- Complete development of the software enhancements that will allow automated identification of loans eligible for cross-servicing, and promptly refer all such loans to FMS for cross-servicing.
- Maintain supporting documentation, in an appropriate level of detail that can be made readily available for independent verification, for all SFH debts reported and certified to Treasury as excluded from referral for collection action. At a minimum, the documentation should include, for each exclusion category (e.g., foreclosure), the total amount reported as excluded on the certified TROR and a listing of the identities and dollar amounts of the specific loans excluded.

Agency Comments and Our Evaluation

A draft of this report was provided to the secretary of agriculture for her or a designee's review and comment. Agriculture's Rural Development mission area, which includes RHS, provided the department's comments. The following discussion highlights Rural Development's most significant comments and our evaluation. Rural Development's letter is reprinted in appendix I.

Rural Development disagreed with our findings that RHS has failed to make DCIA a priority and delayed implementation of certain key provisions. Our position remains unchanged. The details in the body of our report demonstrate RHS's lack of progress. Most importantly, 5 years after the passage of DCIA, RHS had not established an adequate framework or systems capacity to effectively carry out its responsibilities.

Rural Development stated that the department and the agency were committed to fully implementing the recommendations provided by GAO and that it had already established an aggressive schedule for doing so. The agency specifically stated that it had implemented or was in the process of implementing three of our four recommendations. Rural Development disagreed with our recommendation to report the entire accelerated balance of delinquent direct SFH loans to FMS as delinquent debt consistent with Treasury's instructions for preparing the TROR. Rural Development stated that the inclusion of only the delinquent portion of collateralized installment loans is consistent with industry standards for delinquency reporting and reporting the entire amount accelerated would not represent the amount legally collectible, and would distort actual risk of loss.

Rural Development's response is not consistent with either RHS's own governing debt collection policy and practices or Treasury's instructions to federal agencies for reporting accelerated debt balances on the TROR. As stated in this report, when a direct SFH installment loan becomes more than 90 days delinquent, RHS is to notify the debtor by certified mail that the entire loan balance is accelerated and that the full outstanding loan balance is due and payable. The notice also stipulates RHS's intent to foreclose on the loan unless the agency receives full payment of the indebtedness within 30 days of the date of the letter. According to instructions Treasury provided to all agencies subject to DCIA requirements, the entire amount of the debt is to be recorded as delinquent if any part of it has been delinquent more than 180 days, provided the debtor has been notified that the entire amount is due (or accelerated). By failing to follow instructions developed by Treasury for reporting accelerated debt balances, RHS is forgoing opportunities to maximize the collection of delinquent direct SFH loans.

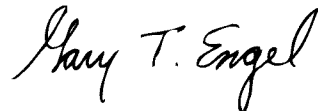
Beyond the requirements of DCIA debt collection initiatives, RHS's underreporting of debts that are due and payable and delinquent more than 180 days distorts the TROR for debt management and credit policy purposes. Such underreporting distorts key governmentwide financial

indicators, including total delinquencies outstanding, on which the president, the Congress, and OMB rely to make important budget and management decisions. Therefore, RHS should report on the TROR all debt amounts more than 180 days delinquent that are due and payable.

As agreed with your office, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after its issuance date. At that time, we will send copies to the chairmen and ranking minority members of the Senate Committee on Governmental Affairs and the House Committee on Government Reform and to the ranking minority member of your subcommittee. We will also provide copies to the secretary of agriculture, the inspector general of the Department of Agriculture, the administrator of the Rural Housing Service, and the secretary of the treasury. We will then make copies available to others upon request.

If you have any questions about this report, please contact me at (202) 512-3406 or Kenneth Rugar, assistant director, at (214) 777-5714. Arthur W. Brouk was also a key contributor to this assignment.

Sincerely yours,



Gary T. Engel
Director
Financial Management and Assurance

Comments from Rural Development

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



United States Department of Agriculture
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

JAN 29 2002

TO: Gary T. Engel
Director, Financial Management
and Assurance
United States General Accounting Office

FROM: Michael E. Neruda *ME Neruda*
Deputy Under Secretary
Rural Development

THROUGH: *Sherie Hinton Henry*
Sherie Hinton Henry
Director
Financial Management Division

SUBJECT: Debt Collection Improvement Act of 1996
Department of Agriculture's Rural Housing
Service Has Not Yet Fully Implemented
Certain Key Provisions

Audit Number GAO-02-308

Thank you for providing the Department and mission area with your Draft Report on the above subject matter. We appreciate the input on how the Rural Housing Service (RHS) (herein referred to as "Agency") can further enhance its ability to collect debts owed to the Agency and Federal Government. We ask that a copy of this response be included in your final Report.

As Deputy Secretary James R. Mosely testified on December 5, 2001, the Department, mission area, and Agency are all committed to fully implementing the recommendations provided by our Office of Inspector General (OIG) and the General Accounting Office (GAO) and had already established an aggressive schedule to accomplish these goals. The Agency has met each milestone under the schedule and will continue to do so.

The Agency has and continues to take its responsibilities under the Debt Collection Improvement Act of 1996 (DCIA) seriously. Further, this Agency continually seeks ways to improve the performance of its loan portfolio. We view ourselves as stewards of the taxpayers resources and, as such, must take all actions necessary to ensure that we manage our loan programs effectively and efficiently. To this end, DCIA is just one tool in a federal lender's overall portfolio management toolbox since DCIA emphasizes the

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collection of defaulted debts. This Agency has spent considerable time and effort improving the underwriting and servicing of Single Family Housing (SFH) loans to ensure that our portfolio does not reach this point. This not only reduces the potential for default, but also ensures a healthy rural America by increasing successful homeownership.

Prior to passage of the DCIA, the Agency had commenced a major reorganization and restructuring of our debt collection practices for our SFH portfolio that is the subject of this Report. These initiatives have saved the taxpayers in excess of \$250 million above and beyond tools available under DCIA. While the Agency does not dispute that further enhancements to our debt collection procedures can be implemented, we respectfully disagree with GAO's findings that we have failed to make DCIA a priority and have delayed implementation of certain key provisions.

In 1996, the Agency established its Centralized Servicing Center (CSC) in St. Louis, MO. Prior to its establishment, the Agency serviced its SFH portfolio through a network of approximately 800 Field Offices. Servicing of the portfolio was not always consistent, and other work performed by Field Offices often took precedence over loan servicing. With CSC, the Agency now has a state-of-the-art service center, comparable, and, in many areas, better than those used by the private sector, that is dedicated to improving the performance of our portfolio. This initiative improved the performance of the portfolio, creating more successful homeowners, and reducing losses and costs to the government and taxpayer. We believe this is the true intent and spirit of debt collection policies of the government.

We support the DCIA's objective to maximize collection of delinquent debts, and to minimize the costs of debt collection. The Agency has taken aggressive action to meet these goals. The overall gross delinquency rate on the direct SFH portfolio has shown a continuous downward trend, from 21% in fiscal year 1998 to a low of 14% in fiscal year 2001. Although our borrowers don't qualify for Federal Housing Administration (FHA) financing, our delinquency net of foreclosure (FHA's reported measure) is less than FHA's Adjustable Rate Mortgage delinquency. The Agency has also made significant improvement in collections under the Treasury Offset Program (TOP). TOP collections increased from \$2 million in 1996 to \$31 million in 2001. Much of this success can be credited to the creation of a state-of-the-art Centralized Servicing Center. RHS has received high marks from GAO and several Congressional staff who have visited the Center and lauded its effectiveness and efficiency in debt collection.

With regard to GAO's specific comments, the commercial off-the-shelf system used by RHS does, in fact, allow identification of loans eligible for cross-servicing. However, an automated process is needed to speed the review process and to avoid redundant data entry for both RHS and Treasury in

See comment 1.

submitting debts for cross-servicing. The Agency did not proceed earlier with these system enhancements since we were engaged in negotiations with Treasury over possible approval as a Debt Collection Center and it was not in the Government's best financial interest to unnecessarily modify a system if the exemption requests were approved. During this timeframe, however, the Agency continued to collect significant dollars on delinquent debt. RHS will refer all eligible debt for cross-servicing by the end of 2002.

See comment 2.

We disagree with GAO's conclusion that Rural Development does not maintain documentary evidence to support the delinquent debt exclusions reported in the Treasury Report on Receivables (TROR). GAO based its conclusion on a one-time event that occurred because of changes that were being implemented in Rural Development's reporting process. For the September 2000 reporting period, Rural Development made significant improvements to the report used to extract the statistical information needed for the TROR.

The program used to extract the information reported on the September 2000 TROR was subsequently implemented and was used in the preparation of the December 2000 TROR. These files are currently retained and support the delinquent debt exclusions. GAO was given the opportunity to review these files during their audit, and they declined. In addition, Rural Development personnel suggested to GAO several alternative techniques for evaluating the reasonableness of TROR exclusions reported in September 2000. This included reviewing the software program logic used to create the December 2000 and subsequent TROR reporting files and testing the accuracy of the reported exclusions. The auditors declined to undertake these reviews.

See comment 3.

With regard to the SFH Guaranteed loan program, GAO reports that the Agency "had not taken steps to recognize the losses that it paid on SFH loans to guaranteed lenders as a federal debt and could not apply DCIA debt collection remedies to them." This statement is not accurate. The Agency has recognized this opportunity and has already begun the process to promulgate rules to implement this enhancement.

As background, the SFH guarantee program is a fairly new program that began in 1991 as a pilot. Recognizing the significant costs experienced by the Department of Housing and Urban Development (HUD) and Department of Veterans Affairs (VA) of having defaulted federally guaranteed loans assigned to the federal government and the potential for acquisition of the property, the Agency established the program differently. Rather than acquire loans and properties, the Agency made the decision to require the lender to be responsible for the entire liquidation process including property acquisition and disposition. The Agency relationship is strictly with the lender—no relationship was established between the homeowner and Agency. This

saves the Agency millions of dollars in not having to liquidate loans, acquire government inventory and dispose of properties.

The Agency later became aware that because the philosophy underlying the establishment of the program (again prior to enactment of DCIA) did not include a contractual relationship with the homeowner, we were precluded from using DCIA tools to collect a non-federal debt. The Agency is amending its forms and regulations to establish this relationship for future loan guarantees.

See comment 4.

The GAO Report contends that the Government has lost the opportunity to collect millions of dollars because it cannot use the tools under DCIA. While we support the use of DCIA to collect upon these losses, the estimated recovery purported by OIG and GAO is grossly overstated. To date, \$21.5 million in SFH direct loans have been referred to Treasury for cross-servicing. Treasury has collected only \$34,000 to date, or less than \$2 for each \$1,000 referred. The vast majority of which was collected through TOP, rather than actual account servicing.

In response to your specific recommendations, we offer the following:

GAO Recommendation: Report the entire accelerated balance of delinquent direct SFH loans to FMS as delinquent debt in accordance with Treasury's instructions for preparing the TROR, and, absent any allowable exclusion, as debt eligible for referral to FMS for collection action.

See comment 5.

Rural Development Response: We disagree. The inclusion of only the delinquent portion of collateralized installment loans is consistent with industry standards for delinquency reporting. Reporting the entire amount accelerated would distort any comparison of delinquency with industry standards, would not represent the amount legally collectible, and would distort actual risk. Nonetheless, even if the entire accelerated balance were reported, those balances would not be eligible for cross-servicing until foreclosure actions were completed and the collateral liquidated. When foreclosure action is completed, we currently report the entire remaining loan balance due as delinquent on the TROR.

Regarding referrals for TOP, the GAO report states that RHS may have understated amounts eligible by not reporting the entire accelerated balance. The report suggests that if we are concerned about legal collectibility, we can exclude loans in foreclosure until collateral disposition from TOP. However, in order to maximize collection, we already refer loans in foreclosure, but only the portion that is delinquent. Laws in many States allow the customer to cure the delinquency (without paying the entire accelerated balance) and remove the account from foreclosure. Additionally, a pre-foreclosure offset in some states (e.g. California) would preclude a subsequent foreclosure. We

believe that our current use of offset to collect the delinquent amount due, prior to engaging in costly foreclosure action is more in line with the stated objectives of DCIA. If we waited until after collateral is liquidated in foreclosure to refer any remaining amount due to TOP, we would be foregoing opportunities to maximize the collection of delinquent debt. We would also lose the opportunity to minimize potential losses and the amount of money the customer must bring to the table to retain homeownership.

See comment 6.

For example, GAO's recommendation would mean that a customer in foreclosure who owes a total of \$25,000 and is \$2,000 delinquent on their loan, would be able to receive a \$2,100 income tax refund because (based upon GAO's recommendation) the data would be excluded. Following the method currently used by the Agency, the \$2,000 delinquency would be reported under TOP, and the \$2,000 would be collected under TOP.

GAO Recommendation: Finalize and implement necessary regulatory changes and modifications to lender agreements to recognize losses on guaranteed SFH loans as federal debt and promptly refer such debt to FMS for collection action.

Rural Development Response: The Agency is in the process of finalizing and implementing necessary regulatory changes and modifications to lender agreements to recognize losses on guaranteed SFH loans as a federal debt.

GAO Recommendation: Complete development of the software enhancements that will allow automated identification of loans eligible for cross-servicing and prompt referral of all such loans to FMS for cross-servicing.

Rural Development Response: The Agency is in the final stages of completing development of the software enhancements that will allow automated identification of debts eligible for cross-servicing and prompt referral of all such loans to FMS for cross-servicing.

GAO Recommendation: Maintain adequate supporting documentation to allow independent verification of all SFH debts reported and certified to Treasury as excluded from referral for collection action. At a minimum, the documentation should include for each exclusion category the total amount reported as excluded on the certified TROR and a listing of the identities and dollar amounts of the specific loans excluded.

See comment 7.

Rural Development Response: Rural Development policy is to maintain sufficient documentary evidence to support the delinquent debt exclusions reported in the TROR. These files are available for GAO's independent verification.

The following are GAO's comments on Rural Development's letter dated January 29, 2002.

GAO Comments

1. RHS's comments misrepresent its system's ability to identify and promptly refer eligible debts to FMS for collection purposes. As stated in this report, RHS officials told us that RHS has been unable since converting to a commercial off-the-shelf loan-servicing system during 1996 and 1997 to readily identify direct SFH loans that are eligible for referral to FMS for cross-servicing because the necessary software was not completed prior to conversion. In order for RHS's automated system to identify direct SFH loans eligible for cross-servicing, it must, for example, be capable of determining the status of any collateral because, according to RHS's requirements, all collateral must be liquidated prior to a loan's referral to FMS for cross-servicing. It was for this reason that RHS had to initiate an interim manual process, which RHS officials characterized as tedious and labor-intensive, to identify direct SFH loans eligible for cross-servicing until planned completion of loan-servicing software in April 2002 that is intended to permit automated identification of direct SFH loans eligible for cross-servicing.

Rural Development's contention that RHS did not proceed earlier with the required systems enhancements needed to promptly refer eligible debts to FMS for cross-servicing because negotiations were taking place with Treasury over possible approval as a Debt Collection Center is not consistent with Treasury's perspective on allowing RHS to service its own loans. As stated in this report, according to Treasury, Treasury/FMS received a formal request to exempt SFH loans from cross-servicing from Agriculture in November 2000. However, prior to the submission of the formal request to Treasury, FMS had informal discussions with Agriculture officials concerning the request, wherein FMS did not encourage the submission of the formal request because it was felt an exemption was not warranted. According to Treasury officials, Treasury never approved a proposal to exempt RHS SFH loans from cross-servicing, either formally or informally.

2. RHS acknowledges that the supporting documentation for the September 30, 2000, TROR was not available. Although RHS contends that the missing documentation was a one-time event due to changes that were being implemented in Rural Development's reporting process, we could not consider reviewing other time periods because,

as agreed with the requester, we were asked to review exclusions as of September 30, 2000, the most recent period as of the date of our fieldwork for which data were certified as accurate by the agency.

We could not consider the alternative techniques suggested by Rural Development personnel, such as study the software program logic used to create the December 2000 TROR, because none of the suggested techniques would result in a list of individual loans that were included in each exclusion category as of September 30, 2000. Such a list was needed in order for us to select a statistical sample of loans to test for the appropriateness of exclusions that the agency certified as accurate as of that date.

3. As stated in this report, DCIA was enacted in 1996 and through the completion of our fieldwork, none of the approximately \$132 million in losses incurred on RHS's guaranteed SFH loan program have been referred to FMS for TOP and cross-servicing. The agency recognizes the opportunity to recover such losses using the remedies available through DCIA and has begun the process to promulgate rules to recognize such losses as federal non-tax debts. However, as of September 30, 2000, RHS still had no policies and procedures to recognize losses on guaranteed SFH loans as federal debts and to refer such debts to FMS for TOP and cross-servicing.
4. We did not provide an estimate of the amount of guaranteed losses that may be recovered through TOP and cross-servicing. Rather, as stated in this report, RHS continues to miss opportunities to collect from borrowers the amounts it has paid to cover losses on guaranteed SFH loans. Moreover, such lost opportunities not only involve collection through cross-servicing but TOP as well, which, according to Rural Development in its response, involved collections of \$31 million in 2001 on debts other than guaranteed losses.
5. See our discussion in the "Agency Comments and Our Evaluation" section.
6. This example provided by Rural Development is not consistent with RHS's procedures for accelerating direct SFH loans and Treasury's instructions for reporting accelerated debts on the TROR. See our discussion in the "Agency Comments and Our Evaluation" section for additional details. In view of RHS's response on this matter, we have modified our first recommendation to RHS to include working together

with FMS to resolve any inconsistencies between RHS's reporting of delinquent debts on its TROR and Treasury's instructions for such reporting.

7. See comment 2.

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