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REPORT BY THE U.S.

General Accounting Office

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Limited-Resource Farmer Loans: More Can Be Done To Achieve Program Goals And Reduce Costs

LEVEL II

Since 1978 the Farmers Home Administration has provided more than a billion dollars in low-interest loans to borrowers with limited resources, such as new farmers, disadvantaged farmers, and farmers making changes in their operations who lack the income, credit, or resources necessary to succeed in farming.

This report discusses the improvements needed in program administration and design to:

- provide more management assistance to borrowers by relying on the services of other Department of Agriculture agencies;
- safeguard program funds against misuse; and
- reduce interest subsidy costs.

GAO

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

COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

B-204258

The Honorable John R. Block
The Secretary of Agriculture

Dear Mr. Secretary:

We made a limited review of the Farmers Home Administration's program for providing low-interest rate loans to limited-resource farmers to determine if any improvements were needed to better accomplish the program's goals, safeguard against misuse of program funds, and control subsidy costs. This report contains a number of recommendations concerning problems we found in these areas.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the above committees; the House Committee on Agriculture; the Senate Committee on Agriculture, Nutrition, and Forestry; the Director, Office of Management and Budget; the Assistant Secretary for Rural Development; the Administrator, FmHA; your Inspector General; interested Members of Congress; and other parties.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE
SECRETARY OF AGRICULTURE

LIMITED-RESOURCE FARMER LOANS: MORE CAN BE DONE TO ACHIEVE PROGRAM GOALS AND REDUCE COSTS

D I G E S T

In 1978 the Congress authorized the U.S. Department of Agriculture's (USDA's) Farmers Home Administration (FmHA) to make low-interest rate farm ownership and operating loans to farmers with limited resources to enable them to increase farm production, income, and living standards.

Through March 1981, FmHA had loaned about $1.3 billion at interest rates ranging from 3 percent to 7 percent. In comparison, interest rates charged on FmHA's regular farm ownership and operating loans ranged from 8.5 percent to 13 percent during the same period.

The difference between the interest rates on limited-resource loans and the rates on FmHA's regular farm loans is an interest subsidy. On the $612 million FmHA loaned to limited-resource borrowers in fiscal year 1980, GAO estimated that interest subsidies could total about $32 million during just the first year of these loans.

GAO reviewed the limited-resource loan program to determine whether more supervision and technical assistance was needed to achieve program goals and whether improvements were needed to control costs and safeguard against misuse of program funds. (See p. 4.)

ASSISTANCE TO BORROWERS HAS BEEN LIMITED

FmHA recognized that limited-resource farmers, if they were to succeed in farming, would need more management assistance than other FmHA farm-loan borrowers. Despite FmHA's efforts to emphasize this to its field offices, GAO found that the management assistance provided to limited-resource borrowers has been inadequate and/or limited. As a result, borrowers will have a harder time succeeding in farming and the program's goal of increasing these borrowers' production, incomes, and living standards could be impaired. (See p. 6.)

FmHA management assistance, which consists of credit counseling, planning, supervision, and yearend analysis of farming operations, was inadequate and/or limited because:

--FmHA did not always identify the weaknesses that limited-resource borrowers needed to address or the key farm or financial management improvements or practices needed to develop a viable farm operation.

--Significant information was sometimes omitted from annual farm plans and long-range planning was shallow or nonexistent.

--The importance of, and need for, a recordkeeping system was not always discussed.

--Farm visits were not always made, or when made, were not thoroughly planned.

--Yearend analyses of farm records and operations were not always made to determine progress, problems, and needed corrective actions. (See p. 7.)

FmHA could provide better program guidance to help ensure that needed management assistance is provided, but this alone will not solve the problem as FmHA staffing has not been adequate to provide the level of assistance needed. (See p. 12.)

FmHA encouraged its field offices to obtain additional assistance for limited-resource borrowers from other USDA agencies, such as the Soil Conservation Service and the Cooperative Extension Service. But GAO found that these agencies were not being used effectively. Neither FmHA headquarters nor the two FmHA State offices GAO visited had developed formal working agreements with other USDA agencies to ensure that needed assistance would be provided. (See p. 14.)

NEED FOR BETTER INTERNAL CONTROLS

GAO found that FmHA had made a couple of limited-resource loans to borrowers who appeared to be able to pay the regular FmHA interest rate and thus were ineligible for the low-interest rate loans. Also, loan files were not always fully documented to support the loans, thus raising questions about the validity of other loans GAO reviewed. USDA's Office of Inspector General found similar problems in its review of the program.

For some borrowers, interest subsidies could total as much as $23,500 during just the first year of their loans. Because subsidies can be substantial, internal controls must be adequate to assure that only eligible borrowers receive them.

A good internal control system should provide for a separation of duties and procedures governing the authorization, preparation, review, and flow of transactions through the system. However, under FmHA procedures, the FmHA county supervisor not only approves loans but exercises considerable control over loan processing and documentation with little or no scrutiny from others before the loans are approved. (See p. 18.)

SUBSIDY COSTS CAN BE REDUCED

Farm values more than tripled from 1970 to 1980 and future increases are expected. For this reason, GAO believes it may be possible to recapture interest subsidies on limited-resource farm ownership loans from the appreciation in farm values when the farm is sold, transferred, or no longer farmed by the borrower.

The idea of recapturing Federal subsidies from appreciation is not new. In October 1979 FmHA began adding a recapture clause to its subsidized housing loans. FmHA estimates that it could eventually recapture as much as 73 percent of its housing subsidies. FmHA had considered seeking legislation to recapture subsidies on limited-resource farm ownership loans but dropped the matter when the new administration proposed eliminating the program's subsidies. (See p. 27.)

RECOMMENDATIONS TO THE
SECRETARY OF AGRICULTURE

To help its staff provide more management assistance to borrowers, FmHA should establish working agreements with other USDA agencies. (See p. 16.)

FmHA also should strengthen its internal controls to assure that loan approval decisions are not made by those individuals responsible for processing and documenting information on which decisions are based. (See p. 25.)

To reduce interest subsidy costs, FmHA should seek legislation to permit it to recapture interest subsidies on limited-resource farm ownership loans. (See p. 30.)

GAO also recommends other actions FmHA should take to provide better assistance and improve internal controls. (See pp. 16 and 25.)

COMMENTS FROM PROGRAM OFFICIALS

FmHA program officials agreed that greater use could be made of other USDA agencies, particularly if the Secretary of Agriculture were to assign a sufficiently high priority to such a cooperative effort to ensure implementation at the county level. They believed that internal controls could be improved if it was practical to do so. Also they believed that recapturing Federal subsidies would be in line with the trends in mortgage financing and could be technically feasible. (See pp. 17, 26, and 30.)

Contents

ABBREVIATIONS

ASCS	Agricultural Stabilization and Conservation Service
CES	Cooperative Extension Service
FmHA	Farmers Home Administration
GAO	General Accounting Office
OIG	Office of Inspector General
SCS	Soil Conservation Service
USDA	U.S. Department of Agriculture

CHAPTER 1

INTRODUCTION

In 1978 the Congress amended the Consolidated Farm and Rural Development Act to authorize the U.S. Department of Agriculture's (USDA's) Farmers Home Administration (FmHA) to give limited-resource farmers a lower interest rate on farm loans than the rate FmHA charges other farmers. According to the legislative history, production costs and farm land prices had skyrocketed to such an extent that farming was becoming increasingly unprofitable for many farmers. For example, based on one bank president's interviews with farmer clients in 1977, 52 percent suffered a loss, 39 percent made a profit and 9 percent broke even. Younger farmers were apparently hit harder because their average land costs were so much higher than for older farmers, thus increasing the young farmers' fixed costs. In addition, the sky-rocketing production costs and farm land prices were reportedly responsible for massive increases in the need for agricultural credit.

Because of the high costs of farming and a reported shortage of farm credit, the Congress found that a certain group of farmers and ranchers needed special help in the form of low-cost credit. This group included those with limited resources, beginning farmers, and owners or operators of small or family farms with low incomes. In addition, the Congress found that there were thousands of young farmers trying to get a start each year who also needed low-cost credit due to the large start-up costs, limited initial operations, and limited income.

LIMITED-RESOURCE LOAN PROGRAM

The limited-resource loan program's primary goal is to assist low-income farm operators to increase farm production, income, and living standards. In making such loans, FmHA must determine that the applicant has an acceptable chance of operating successfully, is unable to obtain sufficient credit elsewhere, and lacks the ability to repay an FmHA loan at regular interest rates. According to the legislative history, FmHA instructions, and FmHA officials, two important aspects of the program were to encourage young people to enter farming and to improve the incomes of marginal farmers.

FmHA has identified three groups of individuals as limited-resource farmers: (1) beginning farmers, (2) farmers making changes in their operations, and (3) disadvantaged farmers. Beginning farmers are those having adequate training or farm experience but who do not have the income and other resources, including credit, to enter into a successful farming operation. The second group includes farmers who need to either reorganize, enlarge their operations, inject working capital into their farms, or restructure indebtedness. The emphasis in this group is on farmers who have the opportunity to purchase farms, operators who need to change their farming systems due to economic conditions, and individuals who, without a loan, may be forced out of business. The disadvantaged farmer, or third group, are those confronted with such problems as very limited resources, low income, poor production, financial management deficiencies, inadequate credit, limited education, and/or an unsatisfactory standard of living.

Types of loans, terms, and conditions

FmHA makes two types of farm loans--ownership and operating. Farm ownership loans can be used to purchase or enlarge a farm; construct, buy, or improve farm buildings; develop land and water resources; and refinance debt. These loans are limited to $200,000 for each farmer and are repayable over terms up to 40 years. Since April 1981 ownership loans are repayable at an interest rate of 13.25 percent, or 5 percent in the case of limited-resource farmers. Farm operating loans can be used to purchase farm machinery, equipment, or livestock; pay for farm operation and family living expenses; buy or repair home appliances; and refinance debts. These loans are limited to $100,000 for each farmer and are repayable over terms up to 7 years. Since April 1981 operating loans are repayable at an interest rate of 14 percent, or 7 percent for limited-resource farmers.

The difference between the rates FmHA charges on regular farm loans and limited-resource loans is an interest subsidy. The table below shows the interest rates for regular and limited-resource farm loans since the limited-resource program began, the effective date of the rates, and the subsidy based on the difference between the regular and limited-resource interest rates.

	Interest/subsidy percentage rates					
	Farm operating loans			Farm ownership loans		
Effective date	Regular	Limited-resource (note a)	Subsidy	Regular	Limited-resource	Subsidy
10-1-78	8.50	5.00	3.50	8.50	3.00	5.50
3-28-79	9.50	5.00	4.50	9.00	3.00	6.00
11-1-79	10.50	6.00	4.50	10.00	4.00	6.00
3-6-80	11.00	7.00	4.00	11.00	b/5.00	6.00
12-19-80	13.00	7.00	6.00	12.25	b/5.00	7.25
4-3-81	14.00	7.00	7.00	13.25	b/5.00	8.25

a/Rate pegged administratively at 2 percentage points above rate on limited-resource farm ownership loans.

b/Current legal maximum.

FmHA instructions provide for reviewing all limited-resource loans 3 years after they are made and every 2 years thereafter to ascertain whether the borrower can afford to pay a higher interest rate. If so, the rate can be increased in increments of whole percentage points up to the regular interest rate in effect at the time of the review.

The Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35), which was signed into law on August 13, 1981, provides for charging limited-resource borrowers an interest rate on (1) operating loans that is 3 percentage points below the rate charged on regular farm operating loans and (2) farm ownership loans that is not in excess of one-half of the current, average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities of such loans--a rate about equal to one-half the rate charged on regular farm ownership loans--but not less that 5 percent. These new rates are to go into effect on October 1, 1981. According to an FmHA program official, FmHA did not know whether these new interest rate provisions would allow FmHA to periodically increase a borrower's interest rates up to the then effective rates on regular farm loans.

Volume of activity

FmHA loanmaking policies have given high priority to limited-resource farmers. During fiscal year 1980 State directors were instructed to give applications from limited-resource farmers first priority and to award at least 25 percent of their farm ownership and farm operating loan allocations at reduced interest rates to limited-resource applicants. On October 13, 1980, legislation was signed into law (Public Law 96-438) to set aside at least 25 percent of the farm ownership and operating insured loan authority during fiscal years 1980-82 for low-interest rate loans to limited-resource farmers.

The table below shows the amount of limited-resource loans FmHA approved each fiscal year since program inception through March 1981.

Type loan	Fiscal year	Number of loans	Amount of loans
Ownership:	1979	3,154	$ 237,317,670
	1980	4,385	391,023,170
	a/1981	1,345	111,682,060
Operating:	1979	7,895	213,295,420
	1980	7,762	221,006,110
	a/1981	3,742	109,604,810
Total		28,283	$1,283,929,240

a/Through March 31, 1981.

OTHER AGRICULTURE
ASSISTANCE FOR SMALL FARMERS

In January 1979 USDA declared that it would seek to preserve a place for the small-farm operation in American agriculture and established a small-farm policy to provide assistance to enable small-farm families to increase their earnings from farm and non-farm sources. A USDA priority under this policy was to encourage small-farm families to participate more fully in USDA programs, and all USDA agency administrators were instructed to ensure that small-farm families have access to and use USDA programs.

To implement its policy, USDA developed a network extending to the States, which consisted of (1) a USDA policy committee on small-farm assistance to provide overall policy direction and establish specific objectives, (2) a subordinate working group composed of representatives from the major USDA agencies to conduct small-farm activities, and (3) a small-farm committee within each State rural development committee, composed of USDA State officials, to identify and address small-farm problems at the State level.

Other USDA organizations that provide assistance to small farmers include the Cooperative Extension Service (CES), Soil Conservation Service (SCS), and Agricultural Stabilization and Conservation Service (ASCS).

The basic mission of CES is to help people identify and solve their farm, home, or community problems with research findings, USDA programs, and referrals to other information sources. CES programs are cooperatively financed by Federal, State, and local governments. Federal funds are channeled to land-grant colleges, which carry out extension work through State and county extension offices. County personnel advise farmers, at no charge, on such matters as production methods and developments, financial planning and analysis, marketing of farm products, and land use.

The main objective of SCS is to assist in the conservation, development, and productive use of the Nation's soil, water, and related resources. Offices at the county level give technical assistance to farmers at no cost by developing land-use plans, analyzing natural resource problems, and providing information on such things as conservation methods, proper crop selection, and pasture management.

Generally, ASCS is responsible for making price-support payments and loans to farmers who qualify for assistance in a variety of program categories including commodity price supports, farmer-owned grain reserves, forest improvements, conservation measures, and land damage from natural causes. County personnel are available to farmers to answer inquiries on specific programs, process applications for assistance, and maintain various production statistics and information for their geographic areas.

OBJECTIVES, SCOPE, AND METHODOLOGY

The primary objective of our review of the limited-resource loan program was to determine whether (1) more supervision and technical assistance were needed to achieve program goals (increase limited-resource farmers' production, income, and living standards), (2) improvements were needed to control costs;

minimize the potential for fraud, abuse, and waste; and yet provide maximum benefits to borrowers within their ability to pay, and (3) more data was needed to monitor program implementation and measure program effectiveness. Originally, we had planned to review the program's effectiveness but because program data was lacking and the program was new, we were unable to do so.

We reviewed legislation, regulations, policies, and instructions relating to the limited-resource loan program, including USDA policies on assisting small farmers. Our review focused on loans made in Arkansas and Texas and in five counties within those two States--two in Arkansas and three in Texas. The volume of loan activity and diversity in farming operations were the two main factors considered in choosing the States and counties in our review. In total, FmHA had approved about $92 million in limited-resource loans in the two States. The five counties selected represented a variety of farming operations including dairy, feed grain, rice, cotton, livestock, poultry, and vegetables. For the five counties, we examined in detail and/or obtained selected information on 27 limited-resource loans to 22 farmers.

Our review was made primarily at FmHA's Arkansas and Texas State offices, FmHA district offices, the five FmHA county offices serving the selected counties, and FmHA's headquarters in Washington, D.C. We also visited the SCS State office in Arkansas; one of its district offices, which was responsible for one of the counties we selected; and three county CES offices (two in Arkansas and one in Texas) responsible for three of the counties we selected. We interviewed FmHA, CES, and other USDA officials and two limited-resource borrowers.

Because the President, as part of the budget revisions for fiscal year 1982, proposed eliminating the program's interest subsidies, we reduced considerably the scope of our work as originally planned. Although five counties were visited, indepth work was in progress at only one when we terminated our field work. In addition, we did not obtain sufficient information to determine whether FmHA needed more or better data to monitor program implementation or measure program effectiveness, which was one of our three objectives.

Despite the limited scope of our review, we believe the problems discussed in this report warrant attention because they are attributable to (1) systemic weaknesses in FmHA policies and procedures, (2) imbalances between FmHA staffing and workload, which has been a continuing problem in FmHA, and (3) the program's design.

The matters in this report were discussed with FmHA program officials and their comments have been incorporated throughout the report, where appropriate.

CHAPTER 2

MANAGEMENT ASSISTANCE FOR LIMITED-RESOURCE

BORROWERS COULD BE IMPROVED

FmHA recognized that limited-resource farmers, because of the nature of the problems confronting them, such as low-income, poor production, and limited managerial ability, would need more management assistance than other FmHA farm-loan borrowers if they were to succeed in farming. However, the management assistance provided to limited-resource borrowers has been inadequate and/or limited. As a result, limited-resource borrowers will have a harder time succeeding in farming and to the extent they do not succeed, the program's goal to increase the limited-resource farmers' production, income, and living standards could be impaired.

FmHA could provide better program guidance to help ensure that needed management assistance is provided. But this alone will not solve the problem as FmHA staffing has not been adequate to handle FmHA's increasing workload and yet provide the level of assistance borrowers need. FmHA has tried to encourage its county offices to obtain additional assistance for limited-resource borrowers from ASCS, SCS, and CES, but effective use was not being made of these agencies. Neither FmHA headquarters nor the two FmHA State offices we visited had developed formal working agreements with ASCS, SCS, or CES to obtain needed assistance. Such agreements would be consistent with USDA's small-farm policy, which directed USDA agencies to ensure that small-farm families have access to and use USDA programs.

WHAT IS MANAGEMENT ASSISTANCE AND WHY IS IT IMPORTANT?

According to FmHA instructions, management assistance consists of

--counseling applicants and borrowers on the use of credit,

--helping applicants and borrowers plan their farm operations,

--providing guidance on recordkeeping,

--supervising borrowers, and

--assisting borrowers to analyze their operations.

FmHA believes its management assistance, along with FmHA credit, is essential for increasing the borrower's chance of farming success while protecting the Government's interest. This philosophy applies in general to all borrowers, but in instructions to its field offices, FmHA singled out limited-resource farmers as those who are apt to require additional and/or special help and more supervisory assistance than other farm borrowers if they are to become successful.

FmHA's ASSISTANCE HAS BEEN LIMITED

Despite the limited-resource borrower's special needs for management assistance, FmHA's management assistance has been inadequate and/or limited. In planning, FmHA did not always identify the limited-resource borrower's weaknesses or the key farm or financial management improvements or practices needed to develop a viable farm operation. In addition, significant information was omitted from prepared plans and long-range planning was shallow or nonexistent. The importance of, and need for, a recordkeeping system was not always discussed. In supervising borrowers, farm visits were not always made or when made, not thoroughly planned. For the most part, the five FmHA county offices visited had not changed their farm visitation practices to give more attention to limited-resource borrowers. Finally, year-end analyses of farm records and operations were not always made to determine progress, problems, and needed corrective actions.

Planning

According to FmHA instructions, planning provides a basis for (1) attaining specific production and financial management objectives, (2) management decisions, and (3) FmHA credit and management assistance determinations. In providing planning assistance, FmHA instructions state that the county supervisor will

--stress to borrowers the need to correlate annual plans with long-range plans;

--fully use any plans developed with the assistance of SCS, CES, other agencies, or farm management services;

--provide guidance on the key farm and financial management practices to be followed; and

--assure that plans are feasible.

In providing planning assistance, FmHA uses two forms, a Farm and Home Plan and Long-Time Farm and Home Plan. The Farm and Home Plan, which is used to develop an annual plan of operation, provides for analyzing the financial condition, income, and productive resources of the farm. It provides for setting forth the planned use of crops, pasture, livestock, and livestock products; improvements and key practices for farm, home, and financial management; projected farm and nonfarm income and farm operating and living expenses; and planned capital expenditures and use of credit. The plan also summarizes these factors to determine the debt repayment ability of the applicant.

We found that FmHA, in preparing the Farm and Home Plan, had not always identified specific borrower weaknesses when there were indications weaknesses existed. For example, on a $61,000 operating loan to a 22-year old dairy farmer, the "running record" 1/ indicated that the case was of a "complex nature" and that "special help" would be needed. On two other loans, the only comments in the files were such phrases as "the borrower probably would qualify" (for a limited-resource loan) or "the borrower cannot make his payments on his bank loan and needs refinancing." In none of these cases was there information regarding what part of the borrower's operation needed specific attention or a description of the complexities involved.

In 2 of 13 Farm and Home Plans we reviewed, the plans did not show what, if any, key farm and financial management practices the borrowers were to follow despite the fact that one of the borrowers was a relatively young (age 21), beginning farmer.

In two other cases, we found that significant information was omitted from the plan that would have changed projected cash incomes. In one case, a farmer who had received a $60,550 farm-operating loan was unable to meet the first payment of $21,500 because the FmHA county official overlooked the fact that cash income would not be generated until cattle were sold, which was about 5 months after the installment was due. Arrangements had to be made to reschedule the debt. In another instance, the FmHA county official did not consider in the planning documents that the borrower would be paying one-third of his rice crop as rent, resulting in a potential $12,540 (or 27 percent) reduction in original income projections.

According to FmHA instructions, the Long-Time Farm and Home Plan should reflect the borrower's long-term aims and objectives. The form used for this plan identifies

--the farming system to be followed,

--the present volume of business and production levels and a projection of the volume expected when the long-range plan is in full operation,

--the major adjustment and improvements to be made and the year they are to be made, and

--the capital purchases and cost of improvements required to carry out the plan.

The two borrowers we interviewed both said that FmHA personnel had discussed long-term goals but only in very general terms.

1/Documentation maintained in the loan file describing a variety of actions such as case analysis, visits to the borrower, and contacts with other organizations or individuals.

For one of the borrowers, a Long-Time Farm and Home Plan had not been completed despite the fact that this 25-year old borrower, who had farmed with his father-in-law for 6 years, was now entering farming on his own for the first time. However, this was not contrary to FmHA instructions because FmHA only requires a long-range plan for borrowers making major adjustments or improvements that will not be completed in the first full crop year.

According to one FmHA State official, the Long-Time Farm and Home Plan is too general to be useful. In our opinion, this document is somewhat deficient as it does not require detailed planning and projections for farm and family living expenses, nor does it provide for an operational cash flow analysis of income, farm and family living expenses, capital expenditures, and debt repayments. In this respect, we believe it would be difficult to correlate this long-range plan with the annual Farm and Home Plan as suggested by FmHA instructions.

Recordkeeping

According to FmHA instructions, county supervisors are to assist borrowers in selecting, establishing, and maintaining recordkeeping systems. Such recordkeeping systems may include FmHA Farm Family Record Books, other record books, or a suitable system offered by a farm management service, CES, or commercial recordkeeping or accounting service. As a minimum, the system selected must provide a record of the annual cash flow, beginning and end-of-year balance sheets, and an income statement. An adequate recordkeeping system enables borrowers to make management decisions and analyze their farming operations. Also, it enables FmHA to determine eligibility for loan assistance and assist borrowers in analyzing operations and making management decisions.

At one county office we visited where 43 limited-resource loans totaling $3,440,800 had been made, an FmHA loan supervisor said that he does not recommend a specific type of recordkeeping system, discuss in detail the concepts of keeping books, or give the borrowers a copy of FmHA's Family Record Book. Two borrowers who had received loans of $194,500 and $60,550 confirmed that FmHA officials had not covered recordkeeping in their discussions with them.

Supervision and analysis

FmHA considers the supervision of borrowers important as it protects the Government's interest in the loan and provides an opportunity to help borrowers accomplish the objectives for which the loan was made. According to FmHA instructions, supervision can be given through farm visits, review of farm records, collateral inspections, meetings with borrowers, letters, telephone calls, media releases, and cash flow analysis. FmHA instructions and training materials at one of the FmHA State offices we visited stated that supervision should start with an overall plan which outlines the supervisory actions necessary to assure that the key farm and financial management practices identified in the Farm and Home Plan were accomplished.

Farm visits are an important means of monitoring the farmer's progress and identifying and discussing operational problems. According to training material at one FmHA State office we visited, a farm visit's effectiveness depends on the quality of prior planning and the thoroughness of the visit. As a minimum, FmHA instructions require county supervisors to make at least one farm visit a year to borrowers who have been indebted for less than 1 full crop year. However, for 10 of the borrowers who had had loans outstanding at least 1 year, no farm visits had been made to 4.

Although FmHA instructions and advisory notices recognize that limited-resource borrowers would need more management assistance, FmHA had not changed its priorities for making farm visits to reflect the special needs of the limited-resource borrower. According to FmHA instructions, the following priorities were to be used in scheduling farm visits:

--Problem borrowers.

--Initial borrowers.

--Borrowers receiving annual production type loans.

--Other borrowers.

Of five county offices we visited, only one county office changed its visitation practices to give more attention to limited-resource borrowers. This county office planned to make three visits every year for all limited-resource borrowers.

Even when visits were planned, FmHA county offices were not always successful in making them. For example, one county office we visited planned 13 visits to five limited-resource borrowers during the first year of their loans, but only 4 visits had been made to three borrowers. In addition, farm visits have not always been thoroughly planned. For example, one FmHA loan supervisor said that he does not have any specific objectives in mind when he contacts a borrower. Instead, he considers his visit a "courtesy call" to see how the borrower is doing. A review of two borrowers' loan files confirmed that this supervisor's visits were very limited in scope.

Although FmHA advocates quality farm visits, it has not developed a standard guide or form for FmHA officials to use in planning and carrying out farm visits. In contrast, one county CES office we visited used a prescribed form, which provided for rating such areas as crop and livestock production and various operational practices, to record farm visits. When completed, the form provided a ready reference for pinpointing the strengths and weaknesses of the individual farmers.

In addition to requiring farm visits, FmHA instructions state that county supervisors are to help borrowers review and evaluate their farm operations to determine progress, problems, and needed corrective actions. In conducting such an analysis, the county supervisor is to help the borrower, if assistance is needed, in completing the "actual" portion of the Farm and Home Plan and recording a complete plan for the next year. The county supervisor is to obtain copies of the completed plan and enter the results of the analysis and agreements reached in the "running record" contained in the borrower's loan file.

FmHA instructions state that an analysis is to be conducted for borrowers that are (1) seriously delinquent or problem cases, (2) having financial and/or production management problems, (3) reorganizing or making major changes in operations, or (4) receiving an initial farm operating loan. In the case of the latter, an analysis is to be made at the end of the first full crop year and each year thereafter until the county supervisor determines that the borrower is conducting the farm operation satisfactorily. Also, according to an FmHA advisory notice issued in March 1979, limited-resource borrowers were to receive a complete analysis of their farm records each year.

As previously noted, FmHA county officials had not always discussed recordkeeping systems with limited-resource borrowers. At the FmHA county office where this occurred, the FmHA loan supervisor also said that he does not review the borrowers' records after the loans are made. He said that instead of maintaining records, some farmers rely on FmHA's supervision of their bank accounts to keep track of income and expenses.

The two borrowers we talked with in this county confirmed that FmHA county officials had not only not discussed recordkeeping systems with them but had never reviewed their records. One borrower, a row-crop farmer who received a loan in December 1979, said that his recordkeeping system consisted of filing income and expense receipts in monthly folders and taking them to a public accountant who prepares his tax return at the end of the year. The other borrower, a grain farmer who had just started to farm on his own, said that he did not have a recordkeeping system during the first year of his loan. In the second year, his sister, a public accountant, helped him establish a formal system, which he is now using.

Complete and accurate farm records are necessary to complete the "actual" portion of the Farm and Home Plan and develop new plans. However, for 10 limited-resource borrowers we reviewed, actual results of annual operations were not recorded in the Farm and Home Plans. Therefore, no analysis could be made to identify variances between projected and actual operations and the reasons for such variances. These omissions occurred despite the fact that at three of the five FmHA county offices visited, FmHA officials said that they develop a new Farm and Home Plan yearly for each limited-resource borrower.

USDA's Inspector General also found that management assistance was limited

USDA's Office of Inspector General (OIG) has reviewed 200 limited-resource loans in six States. 1/ According to its draft report, OIG also found that limited-resource borrowers were not always provided with the supervision and guidance needed to establish a successful farming operation. Specifically, the OIG report stated that:

--County supervisors had not always visited limited-resource borrowers to determine if they were operating a viable farm. This condition was noted for 33 farms in two States.

--In five States, county supervisors had not planned or completed yearend analysis for 42 borrowers.

--Long-range plans were seldom prepared. This condition was noted in each of the six States visited. For example, in two of the States, 24 of the 26 borrowers reviewed did not have a long-range plan.

STAFFING AND WORKLOAD IMBALANCES LIMIT THE LEVEL OF FmHA ASSISTANCE

FmHA State, district, and county office officials we interviewed in Arkansas and Texas said that they were concerned about the effects of heavy workloads on their capability to serve borrowers. They said that because of their heavy workload they have been unable to increase farm planning and supervision to limited-resource borrowers. Also, several thought that the agency has been hindered by a decline in personnel with adequate backgrounds in agriculture and lending practices. Testimony presented at congressional hearings on the fiscal year 1981 budget reflected similar viewpoints, and in June 1980, the House Committee on Appropriations (H. Rept. 96-1095) went so far as to say that many young farmers today are in serious financial trouble because FmHA does not have the time or expertise to provide adequate advice, counseling, and guidance on the purchase of land or farm equipment.

We did not perform a detailed analysis of staffing patterns at the counties visited; however, we found that several are experiencing personnel problems. One county office was without an assistant supervisor, and the county supervisor had no idea when or if the position would be restaffed. The workload administered at this location included 764 loans to 521 borrowers.

1/Kansas, Maryland, Delaware, Massachusetts, Rhode Island, and Connecticut.

Another county supervisor complained that constant turnover in staff has made it difficult to properly supervise the 1,724 loans that were outstanding to 1,118 borrowers. The staff at this location had been increased with temporary employees to make special loans to farmers suffering losses from natural disasters, but these employees and one of the two assistant county supervisors were expected to be transferred in the near future. The county supervisor was uncertain of whether the assistant would be replaced.

A third county office had three permanent employees to service 1,192 borrowers, and only the county supervisor had formal training in agriculture. At the time of our visit, five temporary employees were assigned to administer the disaster loan programs, but two of these employees had less than 6 months experience in FmHA farm programs.

A longstanding problem within FmHA has been the growth of program activities without corresponding increases in staffing. Congressional budget hearings in fiscal year 1981, as well as prior studies by OIG and GAO have discussed this issue and the need to increase employment levels. The nature of the problem is illustrated by the following statistics. (More detailed information is included in app. I.)

--From 1970 to 1980 the number of FmHA borrowers increased from 477,240 to 1,185,241, or 148 percent. During this period, staff years increased from 7,663 to 11,813--an increase of only 54 percent.

--From 1970 to 1980 the value of all outstanding loans increased from $6.525 billion to $44.630 billion, or 584 percent. Consequently, the average value of loans for which each staff member is responsible increased from $1,065,000 to $4,876,000.

--In fiscal year 1970 FmHA granted loans totaling $1.639 billion; in fiscal year 1980 it granted loans totaling $12.966 billion.

By the end of fiscal year 1981, FmHA projects that it will have more than 1,420,000 loans worth $56 billion to supervise and service.

In response to congressional concerns over FmHA staffing and workload, the Congress authorized FmHA to increase its full-time personnel for fiscal year 1981 by 400 of which 200 were for increasing the staffing of county offices to meet the need for credit counseling, debt collection, and loan servicing. By January 1981 FmHA had allocated 204 additional full-time positions to its State offices. However, by May 1981 FmHA had reduced the States' allocation by 148 positions, leaving a net increase of only 56 positions.

According to an FmHA budget official, FmHA allocates positions to its State directors, who in turn are left to decide how these positions will be used within their States, including the positions to be allocated to the county offices. This official said that when additional positions are allocated, the State directors are advised of any congressional interest concerning their use. At the time of our review, information was not available at FmHA headquarters to determine to what extent the State directors had reallocated the 56 positions to their county offices.

The administration's revised budget proposal for fiscal year 1982 provides for 8,575 full-time personnel, or 189 less than what the Congress authorized for fiscal year 1981. This proposed staffing reduction although small would be accompanied by a significant reduction in FmHA lending activities. Specifically, the proposed budget would reduce FmHA's direct lending authority by about $5 billion in comparison with its fiscal year 1981 lending authority and eliminate FmHA loan guarantees for businesses and industries.

OTHER AGRICULTURAL GROUPS COULD BE BETTER UTILIZED

Although staffing and workload problems have limited FmHA's ability to provide management assistance to limited-resource borrowers, FmHA has not made effective use of other agriculture assistance groups such as ASCS, SCS, and CES.

Shortly after the limited-resource loan program began, FmHA issued an advisory notice that called for obtaining additional assistance from ASCS, SCS, and CES for those disadvantaged borrowers (farmers) who need help beyond financial assistance. Also, as previously noted (see p. 7), FmHA's instructions on management assistance state that the county supervisor should fully use any plans developed with the assistance of SCS, CES, or other agency or farm management services.

Despite FmHA's intentions to use SCS, CES, and ASCS assistance, neither FmHA headquarters nor the two FmHA State offices we visited had developed formal working agreements for cooperation among the agencies regarding limited-resource borrowers. In our opinion, such an agreement would be consistent with USDA's small-farm policy (see p. 3), which directed USDA agency administrators to take the necessary steps to ensure that small-farm families have access to and use USDA programs.

In the two States we visited, agriculture agencies did not coordinate program efforts to provide maximum assistance to the limited-resource borrower. The small-farm committees that are part of the network used to implement USDA's small-farm policy had not been aggressive in developing and carrying out small farm plans. The Arkansas small-farm committee held meetings and developed a plan but no action was taken to implement specific objectives. This group is no longer active. In Texas, agency officials apparently discussed a small-farm program but did not develop a plan for one. In addition, an FmHA Texas State official told us that the limited-resource loan program was never a topic of discussion among participants.

The absence of interrelated strategies is also apparent at the county level. One FmHA county official was uncertain whether the other agencies had been informed about the availability of limited-resource farm loans. We contacted other agency officials and found that they were only vaguely familiar with this FmHA program.

In the absence of formal working agreements, farm planning and supervision for limited-resource borrowers do not have the collective input of all interested agencies. This occurs even when the agencies' county offices are located in the same towns and often in the same buildings. One FmHA county official said that ASCS, SCS, CES, and his office experimented with a joint approach to assist four small farmers several years ago. Although they were successful in making visits together and in analyzing the needs of each operation, they discontinued the practice because the farmers were not always receptive to the advice given them. In another county, officials of the four agencies meet to discuss farm program matters but only in emergency situations.

Each agency apparently relies on referrals when specific assistance is known to be needed; that is, FmHA county officials inform the borrower of the assistance each agency has available and the borrower is on his or her own to seek out the service. However, this approach provides a poor exchange of information and feedback on individual borrowers and often prevents the FmHA county office from having complete and current information on the borrower's operation. For example, a row-crop and cattle farmer who had received a limited-resource loan decided to explore the possibility of putting in necessary irrigation equipment to grow rice. Local SCS staff surveyed his land and advised him on placement of the well. However, FmHA county officials were not notified of the contact, the work performed for the farmer, or the results.

This fragmented approach also does not provide the comprehensive farm planning and assistance possible from a coordinated effort. At one county office, for example, we found that only 4 of 13 selected limited-resource borrowers were on CES's mailing list to receive information on production meetings and services. As a result, one borrower, who was planning to grow rice, did not realize that the CES county office conducts meetings with rice farmers to discuss matters of concern to all of them.

CONCLUSIONS

FmHA has singled out the limited-resource farmer as one who requires a higher degree of management assistance to have a reasonable chance of success. This assistance was envisioned to be in the form of farm planning and supervision after the loan was made. Thus far, however, the agency has not been able to provide this additional help. As a result, the limited-resource borrower's chances to succeed in farming will be more difficult and the program's objective of increasing the limited-resource farmers' production, income, and living standards may be impaired.

To carry out the program as envisioned, FmHA will have to improve its program guidance to specify the priority limited-resource borrowers should receive in terms of supervision. In addition, better technical aids are needed to improve long-range planning and supervision and FmHA needs to reemphasize the importance of recording and analyzing data on actual operations. But these actions alone will not be sufficient to ensure that needed management assistance is provided to limited-resource borrowers, considering FmHA's longstanding staffing and workload problem. Although additional staffing and/or decreasing workloads would help resolve this problem, more could be done to make effective use of the resources available from other agencies such as SCS, ASCS, and CES.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

To help augment FmHA staffing and at the same time provide more comprehensive planning, supervision, and assistance to small or limited-resource farmers, we recommend that the Secretary of Agriculture direct the FmHA Administrator to make more effective use of the resources available from other USDA agencies by establishing formal working agreements and referral systems and performing joint farm planning for existing and any future limited-resource borrowers and report back to the Secretary on the progress and problems being encountered in obtaining such cooperation.

To further improve FmHA's planning and supervision efforts, we also recommend that the Secretary direct the FmHA Administrator to:

- --Revise FmHA instruction 1924-B to specify the priority to be given in supervising limited-resource borrowers.

- --Develop more appropriate technical aids or forms to encourage more effective long-range planning of a borrower's farm operation and in planning and carrying out farm visits.

- --Emphasize to FmHA county officials the importance of recording in the Farm and Home Plan the actual results of the annual farm operations.

COMMENTS FROM PROGRAM OFFICIALS

In discussing our draft report with the FmHA Deputy Administrator for Farm and Family Programs and his staff, FmHA program officials generally agreed that greater use could be made of other USDA agencies to provide assistance to limited-resource borrowers. FmHA officials said that although FmHA had general working agreements with other USDA agencies, no special agreements for the limited-resource program had been established. FmHA program officials had no problems with our recommendation that FmHA develop such agreements with other USDA agencies, but they believed that if this effort was to be successful, the Secretary of Agriculture would have to emphasize the need for a cooperative effort among USDA agencies and assign such a cooperative effort a sufficiently high priority to ensure implementation at the county level. As a part of this cooperative effort, they believed that it would be essential for other USDA agencies to coordinate their assistance efforts, especially planning assistance, with FmHA. For example, they said that since FmHA was responsible for the economic feasibility of the loan, any farm plans would have to be reconciled to this reality.

FmHA program officials did not have any particular problems with revising their instructions to specify the priority to be given in supervising limited-resource borrowers. However, they said that FmHA had not had the staff to even carry out fully and effectively its supervision of problem cases, which were to receive the highest priority under current instructions. In addition, FmHA program officials generally agreed that long-term planning could be improved and they had no objections to emphasizing to FmHA county officials the importance of recording and analyzing the actual results of the annual farm operations.

CHAPTER 3

NEED FOR BETTER INTERNAL CONTROLS

Interest subsidies 1/ in the limited-resource loan program are substantial. Subsidies for one borrower could total $23,500 on just the first year of the loans. Because subsidies can be substantial, the program's internal controls must be adequate to assure that only eligible borrowers receive limited-resource loans. But this is not the case in the limited-resource loan program. FmHA made a number of questionable limited-resource loans to borrowers who appeared to be ineligible for such loans. Loans to other borrowers also appeared questionable because borrower's loan files were not always fully documented to support the loans.

A good internal control system should provide for a separation of duties and procedures governing the authorization, preparation, review, and flow of transactions through the system. However, under FmHA procedures, one individual, primarily the FmHA county supervisor, can exert considerable control over the loan processing, documentation and approval functions, as well as other decisionmaking functions, with little or no scrutiny from inside or outside sources before decisions are finalized. FmHA could correct this problem if it revised its procedures to assure that loan approval decisions are not made by those individuals responsible for processing and documenting the information on which decisions are based. By separating duties, decisionmakers would be able to act as reviewers, who ask the "hard questions" and insist on documented answers before making a decision.

SUBSTANTIAL SUBSIDIES ARE AVAILABLE TO BORROWERS

Substantial interest subsidies are available to limited-resource borrowers. Between October 1, 1978, when the program began, and March 31, 1981, FmHA loaned almost $1.3 billion in farm ownership and operating loans to limited-resource borrowers. These borrowers were charged interest rates ranging from 3.5 to 7.25 percentage points less than the regular interest rates charged on FmHA farm loans (see table on p. 2). We estimated that interest subsidies could total about $32 million during just the first year of the loans on the $612 million FmHA loaned to limited-resource borrowers in fiscal year 1980.

1/The interest subsidy is the difference between the interest rates limited-resource borrowers are charged and the regular rates charged to other farm loan borrowers. The latter rates are based on the cost of borrowing money to the Federal Government.

For individual borrowers, the interest subsidy the first year could total $16,500 and $7,000 on farm ownership and farm operating loans, respectively, based on maximum loan limits and the current subsidy, which is based on the interest rates in effect in April 1981. Assuming a borrower obtained both the maximum farm ownership and operating loans, the total subsidy the first year could total $23,500. However, most borrowers do not receive the maximum-size loan nor do they necessarily receive both an ownership and an operating loan. Based on the average-size loan made in fiscal year 1980 and the minimum subsidies available that year, the average first-year subsidy totaled about $5,600 on a farm ownership loan and $1,400 on an operating loan.

Subsidies continue beyond the first year of the loan, but the actual amount of subsidy is difficult to determine because

--loans vary from 1 to 40 years;

--the annual debt repayments are not always scheduled in equal installments over the life of the loan, particularly on operating loans; and

--a borrower's financial progress is to be evaluated 3 years after the loan is obtained and every 2 years thereafter and the interest rate adjusted accordingly. (See p. 2.)

QUESTIONABLE LOANS TO LIMITED-RESOURCE BORROWERS

To be eligible for a limited-resource loan, the applicant must not be able to repay a farm loan at the regular FmHA interest rates. Despite this requirement, 2 of the 16 borrowers reviewed 1/ appeared to have sufficient repayment ability that they could have paid FmHA's regular farm loan interest rates. One borrower, who received a $77,400 limited-resource loan, was projected to have $62,000 available for debt repayments the first year. The amount due on this loan and other debts was $50,000 that year, leaving $12,000 still available for unplanned expenses. Because the additional first year's interest at the regular FmHA interest rates would only have been about $3,500 more, this borrower appears to have had sufficient repayment ability that the need for a limited-resource loan was questionable.

FmHA instructions require that the loan file include a justification for giving a borrower a limited-resource loan. But in 8 of the 16 borrower loan files we reviewed, there was inadequate or no justification.

1/Data on repayment ability was obtained on only 16 of the 22 borrowers we reviewed.

As a minimum, borrowers should be able to repay their low interest rate limited-resource loan. Of the 16 borrowers reviewed, we found that 4 were not expected to have sufficient income to pay all of their expenses and debts, including their limited-resource loans. In one of the cases, FmHA failed to consider that the borrower would have a cash rental expense of $13,000, thus lowering this borrower's repayment ability to $28,300. Payments on this borrower's limited-resource loan and other debts were projected to be in excess of $29,000. On the remaining three, FmHA's projections showed that the borrowers would have insufficient funds to pay their debts.

FmHA uses the Farm and Home Plan to determine a borrower's repayment ability. According to FmHA instructions, the Farm and Home Plan also will be used in subsequent years to evaluate whether the borrower has the ability to pay a higher interest rate. The Farm and Home Plan provides space for (1) including detailed information on crop, livestock, and other farm income; farm operating and living expenses; loans and other credit; and capital expenditures and (2) summarizing this data to determine the amount of funds available for debt repayment. According to FmHA instructions, the plan should be documented in sufficient detail to adequately reflect the overall condition of the operation.

Our review of borrowers' loan files showed that the bases for the data used in the Farm and Home Plan were not always documented in the loan files. This was the case for at least eight of the borrowers we reviewed. For example, we could not determine whether projected crop yields were based on county-wide averages; the specific farm's worst, average, or best yields; or some other basis. Although not documented in the loan files, one county supervisor said that he used county-wide averages to compute the projected crop yield for first-time borrowers and that he did so even if the applicant had been farming the same crop on the same land. Use of county-wide averages when historical data for a particular farm is available could result in over- or underestimating crop yields, and in turn farm income and the borrower's repayment ability.

Support for other projections in the Farm and Home Plan were also absent from the borrowers' files with respect to projected crop or livestock prices and estimated farm operating and living expenses. Also, discrepancies between data listed in a borrower's application and in the Farm and Home Plan were not always explained. For example, one borrower's projected living expenses totaled $10,000, which was $2,000, or 25 percent, more than what was listed on the borrower's application as having been spent in the prior year. Despite the differences, a breakdown of the totals was not included in the application or in the Farm and Home Plan. More importantly, the borrower's file did not contain an explanation or justification for the increase in the Farm and Home Plan.

Inspector General's audit discloses more questionable loans

OIG, in its review of 200 limited-resource loans (see p. 12), questioned 60 loans to 50 borrowers, or 30 percent of the 200 loans reviewed. Loans to these 50 borrowers were considered questionable for the following reasons:

--Eleven borrowers appeared to have sufficient repayment ability to pay the regular FmHA interest rates.

--Three borrowers did not have any prior farm experience or their experience was such that the potential to operate a reasonably successful farm operation was questionable.

--Six borrowers were projected to have a cash farm loss and would need extra nonfarm income, which was not considered in determining the borrowers' repayment ability, to pay living expenses and outside debts as well as absorb the cash farm loss.

--Fifteen borrowers had income and expense projections that were incorrect or unrealistic.

--Twenty-five borrowers had Farm and Home Plans that contained either significant errors or were lacking information to determine eligibility.

--Sixteen borrowers had Farm and Home Plans that contained projected living expenses that appeared excessive and/or income projections that were unrealistic.

--Six borrowers had Farm and Home Plans that made no allowance for taxes or the amount allowed was not consistent with that of a farmer with a viable farm operation.

Because loans to the 50 borrowers were considered questionable for one or more of the above reasons, the number of borrowers shown for each of the above-listed reasons cannot be added to account for the 50 borrowers that received loans that OIG questioned.

OIG attributed these questionable loans to

--vague guidelines for determining eligibility for reduced interest rates,

--some county supervisors' emphasis on making limited-resource loans to 25 percent of all farm-loan borrowers rather than on determining the farmers' repayment abilities (see p. 2),

--few reviews of borrower loan files by higher levels of FmHA management to identify problems and trends, and

--inadequate attention given to including complete and accurate information in the Farm and Home Plans.

IMPORTANCE OF INTERNAL CONTROLS

In a broad sense, internal controls are the methods adopted by an agency to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed management policies. Management controls are the procedures used by operating groups, rather than financial and accounting groups, that are concerned with the decision processes leading to management's authorization of transactions. Internal and management controls are not necessarily mutually exclusive because the procedures and records used for management control may also be necessary for internal accounting control.

A good system of internal control can discourage and minimize fraud, waste, and abuse because of two important features. A good system

--separates duties within the system and

--includes procedures that govern the authorization, preparation, review, and flow of all transactions through the system.

Thus, to succeed in abusing Federal programs or in defrauding an organization having sound internal controls, an individual usually must have the help of others.

Supervisors must play an active role in reviewing operations to ensure that controls exist and are working properly. They cannot rely only on auditors to detect weaknesses or abuses of control systems because audits normally deal with only a small number of transactions that have already transpired.

FmHA's INTERNAL CONTROLS COULD BE STRENGTHENED

Under FmHA instructions, most limited-resource loans are subject to the approval of the FmHA county supervisor. However, under FmHA instructions, county supervisors also play an important role in, or exert considerable control over, loan processing and documentation, and for the most part, the supervisor's actions are not subject to review or concurrence before loan approval is finalized. FmHA instructions also give the county supervisor total responsibility for evaluating the limited-resource borrower's repayment ability in future years and increasing the borrower's interest rates, thus reducing his or her subsidies, based on these evaluations.

Most limited-resource loans are within the county supervisors' approval authority. According to FmHA instructions, those loans that exceed the county supervisor's approval authority are subject to approval by the FmHA district or State office. In the case of farm ownership loans, county supervisors rated as GS-9's can approve loans up to $100,000, and in the case of more experienced county supervisors (GS-11's), up to $175,000. On farm operating loans, county supervisors (GS-9's) can approve loans up to $50,000 whereas more experienced county supervisors (GS-11's) can approve loans up to $90,000. In fiscal year 1980 the average-size limited-resource farm ownership and operating loans were about $94,000 and $34,100, respectively, and therefore subject only to county supervisors' approvals. Most of the limited-resource farm ownership or operating loans we reviewed were also subject to approval by only the county supervisors.

FmHA's county offices are staffed by the county supervisor and clerks. Many, but not all, county offices have assistant county supervisors or loan supervisors--two of the five offices we reviewed did not have an assistant county supervisor. Furthermore, the assistant county supervisor and/or loan supervisor may not be knowledgeable of agriculture, thus limiting their ability to fully process and document a farm loan. More importantly, FmHA instructions do not assign the loan processing and documentation function exclusively to the assistant county supervisor or loan supervisor when the county supervisor is the loan approval official. Under FmHA instructions, the loan approval official can be the same individual who processes and documents the loan.

As previously noted, the Farm and Home Plan is an important document in establishing the borrower's eligibility for a low-interest rate, limited-resource loan. Although FmHA instructions state that this plan is to be prepared by the applicant, FmHA requires that the plan be prepared in consultation with, and subject to the approval of, the county or assistant county supervisor. FmHA instructions also charge these FmHA employees with the responsibility for assuring that the plan is documented in sufficient detail to adequately reflect the overall condition of the farm operation. According to one FmHA district director, the county supervisor can manipulate this plan.

When real estate or chattel property (such as crops, cattle, or farm equipment) is required to secure a loan, which is often the case, FmHA requires that an appraisal be completed by an FmHA employee qualified to perform such appraisals. These employees can include, and have included, county and assistant county supervisors, but not all county or assistant county supervisors are qualified appraisers. Further, once the property is appraised, the loan approval official is responsible for determining whether this security is adequate to protect the loan.

FmHA instructions also charge the county supervisor with the responsibility for determining that an applicant is unable to get credit elsewhere (private credit) to finance the applicant's needs at reasonable rates and terms, thus helping to establish the applicant's eligibility for an FmHA farm loan. In addition, the county supervisor is responsible for making a preliminary determination as to the suitability of the land and buildings for the proposed farm operation.

FmHA instructions place the entire responsibility on the county supervisor for evaluating whether borrowers can afford to pay higher interest rates in subsequent years. If the county supervisor determines that the interest rate should be increased, only FmHA's finance office and the borrower need be informed. If the interest rate remains unchanged, no action need be taken at all.

FmHA does require applicants to be certified by a county committee, 1/ which provides the only separate, independent review of the county supervisor's actions, before a loan can be approved. But these certifications are limited to the applicant's citizenship, creditworthiness, legal capacity to incur a debt, farm training and/or experience, need for farm income, inability to obtain sufficient credit elsewhere, and status as owner-operator of the farm. In the case of a limited-resource applicant, the county committee would have to certify to the applicant's inability to obtain private credit but not the applicant's inability to repay a farm ownership or operating loan at regular FmHA interest rates. In addition, county committees are not required to certify the amount of the loan--often the exact amount is not known at the time of certification.

An FmHA program official confirmed that the county supervisor has the sole responsibility and authority to provide a limited-resource applicant with a low-interest rate loan, at least within the supervisor's approval authority, and to increase as deemed necessary limited-resource borrowers' interest rates. This official also confirmed that the county committee would not participate in such decisions nor would such decisions normally be subject to review by FmHA's district or State offices.

CONCLUSIONS

FmHA has made a number of questionable limited-resource loans, including loans to borrowers who appeared to have the ability to pay FmHA's regular interest rates. This occurred even though FmHA instructions clearly state that borrowers are not to obtain the limited-resource interest rates if they have the ability to pay FmHA's regular farm loan interest rates. FmHA

1/County committees are composed of three individuals residing in the county or area, at least two of whom are farmers who derive a principal part of their income from farming at the time of their appointment.

instructions also specify that the Farm and Home Plan, which is used to determine the applicant's repayment ability, should be fully documented. Yet, this was not always done. Although OIG is recommending that FmHA improve its instructions, internal controls need to be strengthened to ensure adherence to FmHA's instructions.

OIG also is recommending that FmHA monitor the limited-resource loan program more closely. This monitoring can be useful to identify problems and may ultimately result in needed improvements. However, such monitoring occurs after rather than before the loans are approved.

As noted on page 12, FmHA did not have sufficient staff to increase the level of planning and supervision for limited-resource borrowers. The lack of sufficient staff, accompanied by the push to make limited-resource loans to 25 percent of all farm borrowers as reported by OIG (see p. 21), no doubt contributed to the inadequate attention that we and OIG found was given to the preparation of Farm and Home Plans. Although an increase in FmHA staffing would help to solve this problem, FmHA procedures, in our opinion, place too much responsibility on the county supervisor without providing for the appropriate checks and balances available through a separation in duties. To provide for appropriate checks and balances, FmHA needs to ensure to the extent possible that the individual responsible for making decisions, such as loan approval, is not the same individual responsible for processing and documenting the information on which such decisions are made. Such a separation in duties would provide a useful check to ensure compliance with FmHA requirements.

We recognize that the small size of FmHA county office staffs and the workloads throughout FmHA make the separation of duties somewhat difficult. However, county committees and FmHA district and State offices could possibly be used to provide this needed separation in duties.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that the Secretary of Agriculture direct the FmHA Administrator to improve to the extent possible FmHA's internal control system in the limited-resource program by

--assuring that loan approval decisions are not made by those individuals responsible for processing the loan and documenting all the facts in support of loan approval,

--subjecting the county supervisor's decision to increase or continue present interest rates to review and concurrence by another individual or group, and

--using these review functions to assure compliance with FmHA documentation requirements.

COMMENTS FROM PROGRAM OFFICIALS

FmHA program officials said that county supervisors had the same responsibilities as loan approval officials in banks and production credit associations. They also said that county committees operate basically the same as loan approval boards, which banks and production credit associations use to review, and if warranted, approve the decisions of the loan approval officials. FmHA program officials agreed that county committees were not involved as much in loan approval as they once were nor were they considering whether potential borrowers were eligible for subsidized farm loans. FmHA program officials believed the use of the county committee would be one way to help separate responsibilities and that this would be more preferable than using FmHA State or district offices. However, they were concerned whether the county committees would be willing to take on this added responsibility without an increase in the nominal compensation committee members now receive. Thus, they believed this matter would need more study.

CHAPTER 4

SUBSIDIES ON FARM OWNERSHIP

LOANS COULD BE RECAPTURED

Under its housing loan programs, FmHA estimates that it will be able to recapture about 73 percent of its housing subsidy from the appreciation in a house's value when the borrower sells, transfers, or vacates the house. Farm real estate values have appreciated considerably and they are expected to continue increasing. For this reason, recapturing the interest subsidies on limited-resource farm ownership loans offers an opportunity to reduce that program's cost. The recapture concept also offers other benefits. FmHA and USDA officials had previously discussed applying this concept to limited-resource farm ownership loans. But this matter was not pursued due to a change in administration and the new administration's proposal to eliminate limited-resource loan subsidies.

HOW THE RECAPTURE CONCEPT WORKS IN FmHA's HOUSING PROGRAM

The Housing Act of 1949, as amended, authorizes FmHA to make housing loans to low- and moderate-income families who cannot obtain reasonable financing from other sources. The act also authorizes FmHA to subsidize the interest on loans to low-income borrowers. Under this authority, FmHA can charge a low-income borrower as little as 1 percent interest with FmHA paying the difference between the subsidized interest rate and the true interest cost to FmHA. Borrowers can be charged interest rates higher than 1 percent, if they have the income to pay a higher rate, but not in excess of the regular FmHA housing loan interest rate in effect when the loan was made. FmHA reviews the incomes of borrowers at least biennially to determine what, if any, adjustments are needed in the interest subsidy.

Amendments to the act in 1978 authorized FmHA to recapture all or a portion of the interest subsidy upon the borrower's disposition or nonoccupancy of the property. In providing for recapture, the amendments require FmHA to provide incentives for borrowers to maintain the property in marketable condition. Also, the amendments specify that the interest subsidy shall constitute a debt secured by the security instrument given by the borrower.

To provide incentives to maintain the property and at the same time discourage speculators, FmHA has developed a scale to limit the maximum percentage of the gain FmHA will take to recapture the subsidy. This scale is designed to take a decreasing percentage of the appreciation (1) the longer the borrower lives in and owns the house and (2) the higher the average interest rate actually paid by the borrower over the life of the loan. In no instance will FmHA recover more than the actual subsidy. But in computing the actual subsidy, FmHA considers that the principal is reduced faster at a subsidized rate of interest than at a nonsubsidized rate.

FmHA has estimated that it will recapture about 73 percent of the housing subsidies. However, no significant savings have yet been realized as FmHA only began including a recapture provision in those subsidized housing loans closed after October 1, 1979.

FARM REAL ESTATE VALUES ARE INCREASING

Limited-resource farm ownership loans were authorized in 1978 partly in recognition of the increasing cost of farm land and the financial difficulty young farmers have in buying their first land. Reports by the House Committee on Agriculture (H. Rept. 95-986) and the Senate Committee on Agriculture, Nutrition, and Forestry (S. Rept. 95-752) accompanying the legislation cited changes in the average farm real estate values per acre by State for the continental United States between March 1971 and November 1977. The average values for the 48 contiguous States at those dates were $204 and $474 per acre, respectively. By February 1, 1980, USDA's Economics, Statistics, and Cooperatives Service estimated the average value in the 48 contiguous States to be $641 per acre, which is more than 3.25 times the value at the beginning of 1970.

In January 1981 USDA published "A Time to Choose: Summary Report on the Structure of Agriculture." USDA's report stated that:

> "The return in the form of capital gains reflects mainly increases in the value of the largest production asset, land. These returns were relatively stable through the immediate post-World War II decade and the sixties, but then increased rapidly, reflecting the rapid escalation in land prices that began after 1972."

According to USDA's report, farm real estate values are expected to continue to increase. Specifically, the report stated that:

> "* * * A study of probable farm credit needs and problems in the 1980s concluded: * * *
>
>> Land prices probably will increase rapidly, especially in the latter half of the decade. This will increase the wealth of landowners but will also increase the difficulty of getting started in farming, especially for those having no other sources of income to subsidize the beginning years."

The farms bought with limited-resource loans appreciate too. For example, based on FmHA appraisals, the value of one limited-resource borrower's 127-acre farm increased 16 percent, or an average of about $209 an acre, between September 1979 and January 1981.

OTHER BENEFITS FROM RECAPTURE

Besides reducing subsidy costs, a recapture clause in loan agreements could be used to guarantee borrowers a maximum loan interest rate not higher than the regular FmHA rate in effect when the loan was made--a benefit borrowers receive now under FmHA's housing subsidy program. Under the existing program, limited-resource borrowers are to be evaluated 3 years after the date the loan is obtained and every 2 years thereafter to determine whether they can afford to pay higher interest rates. (See p. 2.) Interest rates are to be increased in 1-percent increments up to the then effective interest rate on regular farm loans. The then effective interest rates could be higher or lower than the regular farm loan rates in effect when the limited-resource loan was made. However, as shown in the table on page 2, regular farm loan interest rates have been increasing rather than decreasing over the past 2.5 years. In addition, a recapture provision would help remove the borrower's financial incentive to oppose any subsequent increases in interest rates on farm ownership loans. However, it would probably not mitigate completely a borrower's inclination "to borrow now and pay later."

FmHA CONSIDERED RECAPTURING FARM OWNERSHIP SUBSIDIES

An FmHA program official said that he considered it feasible to recapture subsidies on farm ownership loans. This official said that he and the former FmHA Administrator had met with the former Assistant Secretary for Rural Development in late 1980 to discuss the possibility of seeking legislation to permit the recapture of subsidies on limited-resource farm ownership loans. He said that they had agreed to explore this matter further and that FmHA was putting a proposal (draft legislation) together when last November's election came. However, this official said that the matter was not pursued due to the election results, the change in administration, and the new administration's proposal to eliminate this program's subsidies.

CONCLUSIONS

Subsidy costs could be reduced without negating the objectives of loans to limited-resource farmers by recapturing subsidies when farm real estate is sold, transferred, or no longer farmed by the borrower.

RECOMMENDATIONS TO THE SECRETARY OF AGRICULTURE

We recommend that the Secretary of Agriculture, in an effort to reduce subsidy costs, direct the FmHA Administrator to seek legislation to permit the recapture of Federal subsidies on limited-resource farm ownership loans when the property is no longer farmed by the borrower, sold, or transferred.

COMMENTS FROM PROGRAM OFFICIALS

FmHA program officials said that recapturing Federal subsidies on farm ownership loans when borrowers dispose of the property would be in line with current trends in mortgage financing and could be technically feasible.

FmHA LOAN ACTIVITY AND STAFFING PATTERNS

FISCAL YEARS 1962-80

Fiscal year	Number of active borrowers at end of fiscal year (note a)	Principle outstanding (note b)	Loans made (note c)	Staff years spent	Value of loans for which each staff member is responsible	Staff years for loaning and servicing per million $
		------(billions)------			(millions)	
1962	176,400	$ 1.620	$ .637	5,253	$ .430	2.3
1963	198,632	2.038	.796	5,419	.523	1.9
1964	213,208	2.353	.747	5,484	.565	1.8
1965	243,055	2.753	.800	5,858	.607	1.6
1966	282,400	3.221	1.088	6,590	.654	1.5
1967	328,327	3.914	1.390	7,102	.747	1.3
1968	382,945	4.778	1.359	7,360	.834	1.2
1969	424,400	5.552	1.431	7,272	.960	1.0
1970	477,240	6.525	1.639	7,663	1.065	.94
1971	555,699	7.869	2.414	8,534	1.205	.83
1972	635,895	9.622	2.789	8,866	1.400	.71
1973	719,653	11.206	3.750	8,672	1.725	.58
1974	759,421	12.977	3.591	8,168	2.029	.49
1975	854,524	15.836	5.466	8,359	2.548	.39
1976	920,040	18.456	5.393	8,555	2.788	.36
1977	980,011	22.526	7.236	9,405	3.164	.32
1978	1,054,619	28.712	11.089	10,233	3.952	.26
1979	1,124,526	37.304	14.672	10,842	4.794	.21
1980	1,185,241	44.630	12.966	11,813	4.876	.21

a/Includes individuals and associations but excludes guaranteed loans.

b/End of fiscal year. Excludes guaranteed loans.

c/During the fiscal year.

Source: U.S. Department of Agriculture, "A Brief History of Farmers Home Administration," (Washington: USGPO, Jan. 1981), pp. 21 and 27.

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