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Financial Management and Intergovernmental Relations,  
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Representatives

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**DEBT COLLECTION**

**Agriculture Making  
Progress in Addressing Key  
Challenges**

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Highlights of GAO-03-202T, testimony before the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, Committee on Government Reform, House of Representatives

## Why GAO Did This Study

In December 2001, GAO testified at a hearing before the Subcommittee that the Department of Agriculture, primarily the Rural Housing Service (RHS) and the Farm Service Agency (FSA), faced challenges in implementing key provisions of the Debt Collection Improvement Act of 1996 (DCIA). The testimony focused on RHS's and FSA's progress in referring delinquent debt for administrative offset and cross-servicing and Agriculture's implementation of administrative wage garnishment (AWG).

During the hearing, Agriculture pledged to place a higher priority on delinquent debt collection and to substantially improve the department's implementation of DCIA by December 31, 2002. After the hearing, GAO made recommendations to Agriculture to help the department address the implementation problems GAO had identified.

It is with this backdrop that the Subcommittee requested GAO to review and provide an update on actions Agriculture has taken to resolve these problems. In addition, the Subcommittee requested GAO to report on the status of Treasury's implementation of a debt collection improvement account, a vehicle authorized by DCIA to give agencies financial incentives to improve their debt collection efforts.

[www.gao.gov/cgi-bin/get rpt?GAO-03-202T](http://www.gao.gov/cgi-bin/get rpt?GAO-03-202T).

To view the full report, including the scope and methodology, click on the link above. For more information, contact Gary T. Engel at (202) 512-3406 or [engelg@gao.gov](mailto:engelg@gao.gov).

November 13, 2002

## DEBT COLLECTION

### Agriculture Making Progress in Addressing Key Challenges

#### What GAO Found

Recent actions taken by Agriculture demonstrate increased commitment to DCIA implementation. However, it will take sustained commitment and priority by top management to fully address the problems we identified. GAO's findings include the following:

- RHS has worked to address systems limitations that hampered it from promptly referring debts to Treasury for cross-servicing and is now, according to Treasury, referring all reported eligible debt. The agency will begin reporting certain loans' entire unpaid principal balances on accelerated debt as delinquent, beginning with its report for the fourth quarter of fiscal year 2002. RHS is working on making regulatory changes needed for it to refer losses on guaranteed loans to Treasury's offset program, but the changes are not expected to be completed until about August 2003.
- FSA has developed an action plan to improve its process and controls for identifying and referring eligible debts to Treasury. GAO's review of documents related to the plan indicates that FSA has made progress toward implementing the improvements. In addition, by December 2002, the agency expects to be able to begin reporting information for some codebtors when referring delinquent debts for collection action; to begin referring debts quarterly, rather than annually; and to be able to refer eligible losses on guaranteed loans.
- Agriculture has taken steps toward departmentwide implementation of AWG. Agriculture has completed its AWG implementation plan but still needs to carry out certain elements of the plan, including obtaining from its component agencies specific information on the types of debt subject to AWG and finalizing an agreement with the Department of Veterans Affairs to conduct AWG hearings on Agriculture's behalf. Agriculture has also drafted regulations necessary for implementing AWG, which may not be published until May 2003.

Treasury has established a debt collection improvement account but, to date, it has not been activated because no amounts have been made available in Treasury's appropriations to fund the account. Agencies would be allowed to contribute a portion of their debt collections into the account, and amounts could be used to reimburse agencies for certain expenses related to credit management and debt collection and recovery. Because the account has not been activated, it is difficult to assess how effective it might be in improving federal debt collection beyond the debt collection improvements that have resulted directly from DCIA's major debt collection requirements for federal agencies.

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the Department of Agriculture's (Agriculture's) actions and plans to resolve certain implementation problems involving the Debt Collection Improvement Act of 1996 (DCIA), and the status of the Department of the Treasury's (Treasury's) use of a special financial incentive provision of the act to encourage federal agencies to improve their delinquent debt collection efforts. During a hearing on Agriculture's implementation of DCIA, which was held before this Subcommittee on December 5, 2001, we stressed that the department's implementation of DCIA requirements would have to improve vastly if the debt collection benefits of DCIA were to be more fully realized. Also during that hearing, Agriculture officials pledged to give debt collection higher priority and to substantially improve the department's implementation of the act by December 31, 2002. Subsequent to the hearing, we made a number of recommendations to Agriculture to help it address specific DCIA implementation problems that we identified and discussed at the hearing.<sup>1</sup> It is with this backdrop that you asked us to review actions taken by Agriculture to resolve the specific DCIA implementation problems that we identified and discussed. In addition, given the fact that in recent hearings on DCIA implementation, little if any mention has been made of the act's financial incentive provision's merits, you wanted to know whether Treasury has established a fund or account to implement this provision, and if so, which federal agencies have received payments from the account and for what activities.

Agriculture's full implementation of certain key provisions of DCIA is critical to overall federal nontax debt collection. As a major federal lending agency, Agriculture continues to hold a substantial amount of delinquent federal nontax debt. As of September 30, 2001, Agriculture reported holding about \$6.2 billion of debt over 180 days delinquent. In DCIA, the Congress, with key leadership and support from this Subcommittee, provided agencies, including Agriculture, with a full array of tools to collect such delinquent debt. Among other things, DCIA provides (1) a requirement for federal agencies to notify Treasury of eligible debts delinquent over 180 days for purposes of centralized administrative offset, (2) a requirement for agencies to refer such debts to Treasury for centralized collection action

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<sup>1</sup>U.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).

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known as cross-servicing, and (3) authorization for agencies to administratively garnish the wages of delinquent debtors.

The primary emphasis of my testimony today is on corrective actions taken by two major Agriculture components—Rural Development’s Rural Housing Service (RHS) and the Farm Service Agency (FSA)—to resolve problems associated with the identification and referral of eligible delinquent debts to Treasury for collection action since the December 2001 hearing. I will also provide an update of Agriculture’s departmentwide implementation of administrative wage garnishment (AWG).<sup>2</sup> As you recall, we discussed Agriculture’s actions and plans for implementing AWG in context with information dealing with the extent to which eight other large Chief Financial Officers (CFO) Act agencies and Treasury’s Financial Management Service (FMS) used or planned to use AWG to collect delinquent federal nontax debt.

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## Summary

Today, I am pleased to report that recent actions taken by Agriculture demonstrate that, overall, it now places a higher priority on DCIA implementation. RHS and FSA have made progress in addressing the problems involving identification and referral of eligible debts to Treasury for collection action that we identified, discussed, and for which we made recommendations for corrective action. In addition, Agriculture is making progress in departmentwide implementation of AWG. However, for Agriculture and its agencies to fully address all of the DCIA implementation problems that we identified and discussed by December 2002, or within a reasonable period thereafter, it will take sustained commitment and priority by top management.

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<sup>2</sup>DCIA authorizes both federal agencies that administer programs that give rise to delinquent nontax debts and federal agencies that pursue recovery of such debts, such as Treasury, to administratively garnish up to 15 percent of a debtor’s disposable pay until the debt is fully recovered. Disposable pay means that part of the debtor’s compensation (including, but not limited to, salary, bonuses, commissions, and vacation pay) from an employer remaining after the deduction of health insurance premiums and any amounts required by law to be withheld.

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Regarding the DCIA provision to offer agencies financial incentives for collecting delinquent debt, Treasury established a debt collection improvement account and has twice requested appropriations authorizing expenditures from the fund. Thus far, no expenditures have been authorized. While we support, in principle, the idea of incentives for effective debt collection, the overall success of DCIA has not depended, nor should it, upon the availability or use of a financial incentive. Debt collection is a fundamental aspect of administering credit programs and DCIA contains specific requirements for federal agencies that were designed to improve the collection of the government's delinquent nontax debt. As you know, debt collection has historically not been a high priority at some credit agencies. However, largely due to this Subcommittee's oversight of agencies' DCIA implementation, the envisioned benefit of these requirements has begun to materialize. For example, between fiscal years 1998 and 2001, Treasury's offset program collected over \$10 billion, about 45 percent of which was federal nontax debt.<sup>3</sup> In addition, according to recent Treasury reports, federal agencies governmentwide referred about 93 percent of their reported eligible debt as of fiscal year 2001 for cross-servicing compared to 71 percent for fiscal year 2000, which should bode well for future collections as Treasury has begun to incorporate AWG into its cross-servicing program.

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## Scope and Methodology

To respond to your request, we performed work primarily at RHS, FSA, and Agriculture's Office of the Chief Financial Officer. We also performed work at Treasury and conducted interviews with agency officials at RHS and FSA who are responsible for taking corrective actions to ensure that all eligible delinquent debt is promptly referred to Treasury for collection action. We conducted interviews with Agriculture's CFO and members of his staff regarding Agriculture's implementation of AWG. To corroborate information we obtained from interviews, we obtained and reviewed pertinent agency documents including action plans and implementation schedules. We did not verify the reliability of certain information that was provided to us by agencies such as delinquent debt referred to Treasury. We also did not assess the technical adequacy of the specific systems enhancements that have been deemed by the agencies as necessary for addressing the DCIA implementation problems that we identified and

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<sup>3</sup>In addition to delinquent nontax federal debt, Treasury's offset program collects child support obligations and state income tax debt on behalf of states and tax levies for the Internal Revenue Service (IRS).

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discussed. We conducted interviews with Treasury officials who were knowledgeable about the debt collection improvement account provision of DCIA and the status of the account at Treasury. We performed our work from July through September 2002 in accordance with U.S. generally accepted government auditing standards.

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## RHS Using Its Automated Systems to Make Cross-Servicing Referrals

In December 2001, we testified that, as of September 30, 2000, RHS reported it had referred to Treasury's offset program \$201 million of direct Single Family Housing (SFH) loans but had not referred any amounts to Treasury for cross-servicing, primarily due to RHS's systems limitations. RHS officials told us that since implementing a new automated centralized loan servicing system in fiscal year 1997, RHS had been unable to readily identify direct SFH loans that are eligible for referral to Treasury for cross-servicing. Essentially, the system did not contain sufficient data to differentiate loans eligible for cross-servicing from those that were not. For example, the system needed to be capable of determining the status of any collateral, because all collateral must be liquidated prior to a loan's referral to Treasury for cross-servicing. After the hearing, we recommended that the Secretary of Agriculture direct the Administrator of RHS to complete development of the software enhancements that will allow automated identification of loans eligible for cross-servicing and promptly refer all such loans to Treasury.<sup>4</sup>

RHS has completed and implemented the system enhancements necessary for automated identification of direct SFH loans eligible for cross-servicing and the prompt referral of such loans. In April 2002, RHS made its first automated referral of direct SFH loans to Treasury for cross-servicing. This referral involved about 10,900 loans totaling about \$165.6 million. RHS is currently using its enhanced system to identify loans eligible for cross-servicing and electronically refer them to Treasury on a monthly basis. According to RHS documents and Treasury officials, RHS has referred all of the loans that it has reported as eligible for cross-servicing. Moreover, an RHS document indicates and Treasury officials told us that there have been no significant problems regarding eligibility for cross-servicing for the loans that RHS has referred since April 2002.

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<sup>4</sup>U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture's Rural Housing Service Has Not Yet Fully Implemented Certain Key Provisions*, GAO-02-308 (Washington, D.C.: Feb. 28, 2002).

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## RHS Able to Provide Listing of Excluded Loans for Independent Verification

As we stated at the December 2001 hearing, when we attempted to independently verify specific debts that RHS had excluded from referral to Treasury's offset program as of September 30, 2000, we were told by RHS officials that the supporting documentation for the \$182 million of direct SFH loans excluded from referral had not been saved. We subsequently recommended that the Secretary of Agriculture direct the Administrator of RHS to 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, such as foreclosure, the total amount reported as excluded on the certified Treasury Report on Receivables Due from the Public (TROR) and a listing of the identities and dollar amounts of the specific loans excluded.<sup>5</sup> Such documentation would facilitate an efficient independent review to determine whether RHS's exclusions meet relevant legislative and regulatory criteria. The Comptroller General's *Standards for Internal Control 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.<sup>6</sup>

During our follow-up review, RHS provided us a detailed listing of specific direct SFH loans and the loans' corresponding dollar amounts that had been reported as excluded from referral to Treasury on the TROR as of September 30, 2001, the last period for which certified data were available. Although we were not requested to and did not test the specific loans excluded to determine whether they met relevant legislative and regulatory criteria, RHS's ability to provide such listings should facilitate future independent verifications of the validity of its reported exclusions, and is critical for the oversight of the agency's DCIA implementation.

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<sup>5</sup>GAO-02-308.

<sup>6</sup>See U.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. This standard is critical for the oversight of agency DCIA implementation as the act permits debts to be excluded from referral to Treasury for offset and/or cross-servicing if they are under appeal, in forbearance, in litigation at the Department of Justice, in bankruptcy, or in foreclosure. In August 2000, we reported that 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. See U.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).

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## Treasury Instructs Rural Development to Report Accelerated Balances for RHS's Direct SFH Loans

Treasury is the sole operator of a governmentwide centralized debt collection center. As such, it is critical that Treasury obtain accurate information from federal agencies on the status of their nontax debt, particularly the debt over 180 days delinquent, for which DCIA was designed in large part to help agencies collect through centralized collection. During the December 2001 hearing, we stressed that RHS was only reporting the delinquent installment portion of its direct SFH loans as delinquent in its TROR. It was not reporting, as required by Treasury, the accelerated loan balance, which is the total debt due and payable. In the report we issued after our testimony,<sup>7</sup> we stated that, as a result of such reporting, RHS may have underreported to Treasury direct SFH loan amounts delinquent over 180 days by about \$849 million and direct SFH loan amounts eligible for Treasury's offset program by about \$348 million as of September 30, 2000. We recommended that the Secretary of Agriculture direct the Administrator of RHS to work with Treasury to resolve any inconsistencies between RHS's reporting of delinquent debts on its TROR and Treasury's instructions for such reporting. In addition, we recommended that absent any modifications to Treasury's instructions for preparing the TROR, RHS report the entire accelerated balance of delinquent direct SFH loans to Treasury as delinquent debt and, absent any allowable exclusions, as debt eligible for referral to Treasury for collection action.<sup>8</sup>

After we made our recommendations, Agriculture and Treasury officials met to address the inconsistency that existed between RHS's reporting of delinquent direct SFH loans on the TROR and Treasury's instructions for such reporting. In a September 2002 letter, Treasury informed Rural Development that RHS should report the entire unpaid principal balances as delinquent on the TROR, and requested that such reporting begin with the TROR for the fourth quarter of fiscal year 2002. Treasury stated in the letter that once an acceleration notice is sent to the borrower, which has been RHS's ongoing practice, the entire debt is due and payable and should be reflected as such on the TROR. Treasury also stated that its decision was based on consultation with its legal counsel and recent discussions with Agriculture officials including its CFO. According to RHS officials, the agency will report the entire unpaid principal balances for its direct SFH

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<sup>7</sup>GAO-02-308.

<sup>8</sup>GAO-02-308.

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loans that have been accelerated beginning with the TROR for the fourth quarter of fiscal year 2002.

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## Efforts Under Way, But RHS Will Not Be Able to Refer Guaranteed Losses in the Immediate Future

At the December 2001 hearing, we stated that RHS had not referred losses on its guaranteed SFH loans to Treasury for collection action. RHS officials told us that 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. Consequently, RHS did not recognize the losses that it paid to guaranteed lenders as federal debt and could not apply DCIA debt collection remedies to them. We were particularly concerned about DCIA debt collection remedies not being available for RHS's guaranteed SFH losses because, according to RHS, through September 30, 2000, such losses totaled about \$132 million.<sup>9</sup> After the hearing, we recommended that the Secretary of Agriculture direct the Administrator of RHS to finalize and implement necessary regulatory changes and modifications to lender agreements so that losses on guaranteed SFH loans could be treated as federal debt and referred to Treasury for collection action.<sup>10</sup>

RHS is currently working on making the regulatory changes that are needed to refer losses on guaranteed SFH loans to Treasury's offset program; however, the agency will not be able to refer such losses until regulatory action is completed and guaranteed loan applications are modified. According to a RHS official, to expedite the regulatory recognition of losses on guaranteed SFH loans as federal debt, Agriculture is currently incorporating the regulatory changes that are needed into the draft final rule for the Section 502 Guaranteed Rural Housing Program. It is important to note, however, that the Office of Management and Budget (OMB) has determined that the final rule for this program will constitute a "significant regulatory action." As such, the rule will be subject to a more lengthy clearance process that will involve OMB review in the final

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<sup>9</sup>RHS's guaranteed SFH losses have continued to increase to about \$258 million through the third quarter of fiscal year 2002.

<sup>10</sup>GAO-02-308.

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rulemaking stages.<sup>11</sup> According to a schedule provided by Agriculture, which includes internal agency review as well as OMB review, publication of the final rule for the Section 502 Guaranteed Rural Housing Program is expected by about August 2003.

Given that the aforementioned regulation is not expected to be finalized for a considerable time, it is important to note that, as of our fieldwork completion date, RHS also had not modified the guaranteed loan applications for the SFH guaranteed loan program that are needed to establish a contractual relationship between the debtor and RHS so that losses stemming from SFH guaranteed loans can be recognized as federal debt and be subject to the debt collection provisions of DCIA. Initially, an RHS official stated that RHS planned to make changes to the applications when the final rule for the guaranteed loan program is issued. However, we pointed out that that approach could possibly delay RHS's ability to recognize guaranteed loan losses as federal debt, and we suggested that RHS change the guaranteed loan applications as soon as practicable so that once the rule goes into effect, it may be able to be applied retroactively to cover as many guaranteed loans as possible. As a result, according to an RHS official, RHS consulted with its Office of General Counsel and obtained approval for changing the guaranteed loan applications prior to the issuance of the final rule.<sup>12</sup> Currently, RHS is in the process of revising its guaranteed loan application form to include an acknowledgement that any claim paid by RHS on a guaranteed loan would be subject to provisions of the DCIA.

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<sup>11</sup>Under Executive Order 12866, which was adopted during the previous Administration, OMB reviews all significant regulatory actions to ensure consistency with the principle of good regulatory analysis and policy. At both the proposed and final stages of a major rulemaking, OMB is provided up to 90 days to review an agency's rulemaking package, including the draft rule, the cost-benefit analysis, and any other supporting materials. During the 90-day review period, professional analysts at OMB scrutinize the agency's work and often work with an agency to improve the analysis and/or draft rule. There are ultimately three possible outcomes of an OMB review: (1) clearance for publication in the *Federal Register*, (2) withdrawal by the agency for further consideration, or (3) return by OMB to the agency for reconsideration.

<sup>12</sup>As will be discussed later, FSA modified its guaranteed loan applications for guaranteed farm loans to establish a contractual relationship between FSA and the debtor approximately 1 year prior to finalizing its regulation for recognizing losses on such loans as federal debt. According to FSA officials, all losses on guaranteed loans made after the applications were modified are considered federal loans and subject to DCIA collection remedies.

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Once the regulations are finalized and RHS makes the necessary modifications to the guaranteed loan application, the agency will need to be able to promptly refer guaranteed losses to Treasury's offset program. Given the fact that the SFH guaranteed loan program continues to grow significantly, thereby increasing the number of loss claims being processed each year, automated tracking of guaranteed loan losses and referring them to Treasury will be critically important. RHS has initiated a project to automate the tracking of SFH loss claims from lenders and payments made to lenders to cover such claims, which it plans to complete in April 2003. It is important to note, however, that the project does not cover the process for the automated referral of guaranteed losses to Treasury. According to RHS officials, this automated referral process will not be covered until RHS initiates the second phase of the current project after April 2003, and which is estimated to take an additional 9 to 12 months to complete. However, RHS currently tracks guaranteed losses, and RHS officials stated that referrals to Treasury could be done manually if the automated enhancements needed to make such referrals are not complete.

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## FSA Has Initiated Actions to Improve Its Process and Controls for Identifying and Referring Debts

At the December 2001 hearing, we stated that FSA did not have a process or sufficient controls in place to adequately identify direct farm loans eligible for referral to Treasury. We emphasized that, as a result, amounts of direct farm loans FSA reported to Treasury as eligible for referral were not accurate and, for certain loans, not only distorted the TROR for debt management and credit policy purposes but also distorted key financial indicators such as receivables, total delinquencies, and loan loss data. Specifically, FSA automatically excluded from referral all judgment debts without any review to identify and refer deficiency judgments, which are eligible for Treasury's offset program and should be referred.<sup>13</sup> We emphasized that, as of September 30, 2000, FSA's judgment debts totaled \$295 million, and our inquiries prompted the agency to initiate a manual process to identify deficiency judgments eligible for referral.<sup>14</sup>

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<sup>13</sup>A judgment may represent a judicial declaration that a debtor is personally indebted to a creditor for a sum of money. Judgments may include (1) judgment liens, (2) foreclosures, and (3) foreclosures and deficiency judgments. Deficiency judgments require payment of a sum certain to the United States and are intended to cover the shortfall between the amount owed the United States and the proceeds from the foreclosed property securing the loan.

<sup>14</sup>According to FSA, the agency manually identified 280 judgment debts totaling over \$20 million through June 2002 that were eligible for referral to Treasury's offset program, and subsequently referred the debts to the program.

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Moreover, FSA's Program Loan Accounting System did not contain current information from the detailed loan files located at the numerous FSA county field offices that would be key to determining a farm loan's eligibility for referral to Treasury. In addition, there were no monitoring or review procedures in place to help ensure that FSA personnel routinely updated the detailed loan files that are the source of such key information. The severity of this problem was reflected in the results of our statistical sample of loans that had been excluded by FSA in four large states.<sup>15</sup> Based on our review of this sample, we estimated that about one-half of the excluded loans in the four states had been inappropriately placed in exclusion categories by FSA as of September 30, 2000.<sup>16</sup> One of the most frequently identified inappropriate exclusions pertained to amounts that had been discharged in bankruptcy. Such exclusions involved debts that FSA should have written off and closed out, in many instances, several years prior to our test date. In addition, the written-off and closed-out amounts for such debts should have been reported to IRS as income to the debtor in accordance with the Federal Claims Collection Standards and OMB Circular A-129.<sup>17</sup>

After the hearing, to address these problems, we recommended that the Secretary of Agriculture direct the Administrator of FSA to develop and implement (1) automated system enhancements to make the Program Loan Accounting System capable of identifying all judgment debts eligible for referral to Treasury for collection action, (2) oversight procedures to ensure that FSA field offices timely and routinely update the Program Loan Accounting System to accurately reflect the status of delinquent debts, including whether the debts are eligible for referral to Treasury for

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<sup>15</sup>Using statistical sampling, we selected and reviewed supporting documents to determine whether farm loans that selected FSA county field offices in California, Louisiana, Oklahoma, and Texas had excluded from referral to Treasury were consistent with established criteria dealing with bankruptcy, forbearance/appeals, foreclosure, and litigation. Field offices in these four states serviced about \$272 million, or about 39 percent, of the total debts FSA excluded from referral to Treasury as of September 30, 2000, for bankruptcy, forbearance/appeals, foreclosure, or litigation.

<sup>16</sup>We estimated that 48.5 percent  $\pm$  15.7 percent of the population were inappropriately reported as exclusions from referral to Treasury's offset program. When projecting these errors to the population of 1,187 loans, we were 95 percent confident that the errors in the population were between 389 and 761 loans.

<sup>17</sup>Federal Claims Collection Standards and OMB Circular A-129 require agencies to report the discharge of the debts, also known as close out, to the IRS in accordance with the requirements of 26 U.S.C. 6050P and 26 CFR 1.6050P-1.

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collection action, and (3) oversight procedures to ensure that all debts discharged through bankruptcy are promptly closed out and reported to the IRS as income to the debtor in accordance with the Federal Claims Collection Standards and OMB Circular A-129. We also recommended that FSA continue to manually identify deficiency judgments eligible for referral until the system enhancements for automated identification were completed and implemented.<sup>18</sup>

FSA has developed an action plan to improve its process and controls for identifying and referring eligible debts to Treasury and, based upon our review of documents provided by FSA, the agency has made progress toward implementing such improvements. As of our fieldwork completion date, FSA was using its Program Loan Accounting System and system-generated reports to better track the status of FSA's delinquent debts, including judgment debts, for the purpose of meeting the DCIA referral requirements. Specifically, FSA was generating an enhanced debt report to include various types of debts under FSA's farm loan programs, including judgment debts, to facilitate field office review of debts to determine eligibility for referral to Treasury. In September 2002, FSA provided its field offices the initial enhanced debt report and directed the field offices to review the debts for accuracy. FSA plans to routinely use the enhanced debt report in such field office reviews in the future.

In addition, actions are being taken to improve field office oversight for DCIA implementation. Beginning in August 2002, county field offices must provide their respective state offices with documentation for loans that they determine are ineligible for Treasury's offset program because of bankruptcy, foreclosure, or litigation.<sup>19</sup> The state offices, in turn, are responsible for making the final decision regarding the loans' eligibility for referral and for actually excluding the loans from referral. In addition, FSA has amended its National Internal Review Guide to include specific procedures that are designed to help ensure that state offices, among other things, establish monitoring systems to accurately track borrowers in

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<sup>18</sup>U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture's Farm Service Agency Has Not Yet Fully Implemented Certain Key Provisions*, GAO-02-463 (Washington, D.C.: March 29, 2002).

<sup>19</sup>FSA maintains a state office in each state, usually in a state capital or near a state land-grant university. State offices, among other things, provide administrative support and oversight to county servicing offices, which are designed to be a single location where customers can access the services provided by FSA.

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foreclosure, bankruptcy, and litigation. The procedures are intended to facilitate the timely and routine updating of information in the Program Loan Accounting System to accurately reflect the status of delinquent debts, including whether the debts are eligible for referral to Treasury for collection action, and that all debts discharged through bankruptcy are promptly closed out and reported to IRS. FSA's policy is to perform its national internal reviews at state offices not less than every 2 years, and the new procedures should improve FSA's implementation of DCIA's delinquent debt referral requirements. It is important to note, however, that specific actions in FSA's action plan that are needed to (1) ensure field offices are routinely reviewing accounts for Treasury's offset program and cross-servicing referral eligibility; (2) ensure that field offices routinely monitor the status of accounts and properly code them for foreclosure, bankruptcy, and litigation; and (3) ensure discharged bankruptcy accounts are promptly closed out, removed from the farm loan debt portfolio, and appropriately reported to the IRS as discharged debts, have target completion dates of September 2003.

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## Efforts Under Way at FSA to Begin Referring Codebtors to Treasury

We stated at the December 2001 hearing that even though FSA reported having referred \$934 million of direct farm loans to Treasury's offset program as of September 30, 2000, the agency has lost opportunities for maximizing collections on this debt because it does not refer codebtors. We emphasized that the vast majority of direct farm loans have codebtors and pointed out that FSA's Program Loan Accounting System did not have the capacity to record more than one debtor and that the necessary system modifications to record more than one taxpayer identification number had not been made. After the hearing, we recommended that the Secretary of Agriculture direct the Administrator of FSA to monitor planned system enhancements to the Program Loan Accounting System to ensure that capacity to record and use codebtor information is available and implemented by December 2002.<sup>20</sup>

FSA has acknowledged the need to refer codebtors. Its action plan includes time frames for developing and testing the systems enhancements deemed necessary for recording and reviewing relevant information needed for referring debts to Treasury's offset program, including the codebtor's name, address, and taxpayer identification number. Based on our review of

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<sup>20</sup>GAO-02-463.

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documents provided by FSA, the agency has established a codebtor code for its system and has begun to input codebtor information. According to FSA, as of our fieldwork completion date, 254 loans with codebtors totaling about \$8.3 million had been identified for initiating the due process required for referral to Treasury's offset program in December 2002. Given that the vast majority of the agency's direct farm loans have codebtors, FSA has a substantial challenge ahead to obtain the required information to refer all eligible debt for codebtors to Treasury's offset program.<sup>21</sup>

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## Quarterly Referrals to Treasury's Offset Program to Begin in December 2002

As we noted at the December 2001 hearing, data provided by FSA officials showed that about \$400 million of new delinquent debt became eligible for Treasury's offset program during calendar year 2000. Although FSA officials acknowledged that debts became eligible relatively evenly throughout the year, debts eligible for offset were being referred to Treasury only once annually, during December. As a result, a large portion of the \$400 million of debt likely was not promptly referred when it became eligible. FSA agreed that quarterly referrals could enhance possible collection of delinquent debts by getting them to Treasury earlier. After the hearing, we recommended that the Secretary of Agriculture direct the Administrator of FSA to monitor effective completion of the planned automated system modifications to refer eligible debt to Treasury's offset program on a quarterly, rather than annual, basis.<sup>22</sup>

FSA plans to make quarterly referrals to Treasury's offset program and intends to make the first such referral in December 2002. In August 2002, FSA issued guidance to the field offices for review of eligible debts for the December 2002 referral.<sup>23</sup> In September 2002, FSA informed its field offices that quarterly referrals are now required, and the agency has determined that the same due process notification and referral process that has been used annually will be used quarterly, except under a shorter time frame.

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<sup>21</sup>We noted during our fieldwork that FSA officials were unaware of the requirement to report discharged or closed-out debts to IRS as income for codebtors as required by 26 U.S.C. 6050P and 26 CFR 1.6050P-1. According to FSA officials, FSA's Office of General Counsel has agreed that reporting discharged debts for codebtors to IRS could be done, and FSA is currently researching its systems capability for such reporting.

<sup>22</sup>GAO-02-463.

<sup>23</sup>As of the completion date of our fieldwork, FSA documents indicated that the initial quarterly referral in December 2002 could potentially bring the total direct farm loans in Treasury's offset program to over 35,000 loans totaling about \$1.5 billion.

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## Significant Actions Taken by FSA to Be Able to Refer Guaranteed Losses to Treasury's Offset Program

At the December 2001 hearing, we pointed out that FSA had paid out about \$293 million in losses for guaranteed farm loans since fiscal year 1996, but like RHS, FSA had missed opportunities to potentially collect millions of dollars related to guaranteed loan losses because they were not treated as federal debt. We also noted while performing work at FSA that the agency had revised its guaranteed loan application applicable to guaranteed loans made after July 20, 2001, to include a section specifying that amounts FSA pays to a lender as a result of a loss on a guaranteed loan constitute a federal debt. After the hearing, because FSA needed to make revisions to its Guaranteed Loan Accounting System to classify guaranteed farm loan losses as federal debt, we recommended that the Secretary of Agriculture direct the Administrator of FSA to monitor planned system enhancements to the Guaranteed Loan Accounting System to ensure that the software needed to implement the revisions to the lender agreement to establish guaranteed loan losses as federal debt is completed. In addition, we recommended that once FSA establishes guaranteed loan losses as federal debt and deems them to be eligible for referral to Treasury, FSA timely refer such debt to Treasury for collection action in accordance with DCIA.<sup>24</sup>

FSA has issued the final regulations for recognizing claims paid on guaranteed farm loans as federal debt and is currently making needed systems modifications to refer such losses to Treasury's offset program. According to FSA officials, the July 2002 regulations apply to guaranteed farm loans made after July 20, 2001, the date of the revised guaranteed loan application. FSA has established December 2002 as the milestone date for completing the automated systems capability to refer eligible losses to Treasury's offset program and, according to FSA officials, the agency is on schedule. According to FSA officials, as of our fieldwork completion date, the agency has not paid any loss claims associated with guaranteed farm loans made under the July 20, 2001, revision of the guaranteed loan application, and does not expect to experience such losses in the near future because the loans are relatively new.<sup>25</sup> However, it is important to note that if FSA experiences such losses, it has procedures for the manual referral of guaranteed loan loss debt to Treasury's offset program.

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<sup>24</sup>GAO-02-463.

<sup>25</sup>According to FSA, as of July 24, 2002, \$2.3 billion of guaranteed farm loans had been made under the revised guaranteed loan application.

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## Agriculture Is Working toward Departmentwide Implementation of AWG

At the December 2001 hearing, we stated that Agriculture and eight other agencies we surveyed still had not utilized AWG as authorized by DCIA to collect delinquent nontax debt even though experts had previously testified before this Subcommittee that AWG could potentially be an extremely powerful debt collection tool. We noted that the agencies, including Agriculture, needed to develop the required regulations to implement AWG. In addition, we emphasized that Agriculture had not established specific dates for implementing AWG and was among five surveyed agencies that said they intended to implement AWG in the future but had no written implementation plan for doing so. After the hearing, we recommended, among other things, that the Secretary of Agriculture direct the CFO to complete and finalize regulations for conducting AWG and prepare a comprehensive written implementation plan that clearly defines, at a minimum, the types of debt that will be subject to AWG, the policies and procedures for administering AWG, and the process for conducting hearings, which are required by Treasury. We also recommended that, when practicable, (1) AWG be used in conjunction with other debt collection tools and (2) debts be referred to Treasury prior to 180 days delinquent when relying on Treasury to perform AWG.<sup>26</sup>

Agriculture agrees that AWG has the potential to be a powerful tool for collecting delinquent federal debts and has taken actions to develop needed regulations and has completed a departmentwide AWG implementation plan. As of our fieldwork completion date, Agriculture had drafted AWG regulations and incorporated them into the overall debt collection regulations for the department, which are currently being revised.<sup>27</sup> Agriculture also plans to work with OMB to determine whether Agriculture's regulatory revisions for debt collection should be considered a "significant regulatory action." According to Agriculture's implementation plan, if the regulatory revisions are determined to be a "significant regulatory action," they will require a more lengthy review process resulting in a target date of May 2003 for final publication.

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<sup>26</sup>U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Status of Selected Agencies' Implementation of Administrative Wage Garnishment*, GAO-02-313 (Washington D.C.: Feb. 28, 2002).

<sup>27</sup>Agriculture is currently revising its debt collection regulations, which are contained in 7 CFR part 3, in order to ensure that they reflect implementation of all aspects of DCIA, including AWG, and are consistent with the Federal Claims Collection Standards, issued by Treasury and the Department of Justice in November 2000.

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In addition, Agriculture's implementation plan contains other milestone dates that need to be met and key elements that are needed to implement AWG. In accordance with the implementation plan, the CFO's office has obtained from component agencies their best estimates of the number of AWG cases they are likely to have each year for loans and administrative debt along with a corresponding estimate for the number of requests for hearings. Agriculture plans to have the Department of Veterans Affairs conduct AWG hearings on Agriculture's behalf and has had discussions with Veterans Affairs regarding such services.

To actually perform AWG, Agriculture plans to rely upon Treasury's cross-servicing program for the vast majority of its debt types for specific debts of \$100 or more.<sup>28</sup> Agriculture believes that Treasury's private collection agency contractors already have the knowledge, expertise, and resources to seek out debtors, verify employment sources, and pursue debt collection through AWG. Because of Agriculture's reliance upon Treasury to perform AWG as part of cross-servicing, the CFO's office plans to incorporate into Agriculture's due process notifications to delinquent debtors, which are mailed prior to debt referrals to Treasury, the potential use of AWG as part of cross-servicing. In addition, the CFO's office plans to work with Agriculture's component agencies to refer debts for cross-servicing prior to the 180-day threshold, when practicable. These steps could serve to accelerate collections of delinquent debt.

Although Agriculture has completed its departmentwide AWG implementation plan, components of the plan still need to be carried out. For example, the CFO plans to obtain individual AWG implementation plans from Agriculture's agencies that include each agency's timetable for implementation, written policies and procedures, and types of debt subject to AWG. In addition, Agriculture still needs to work with its agencies to provide Treasury with authorization to use AWG as part of cross-servicing and to complete the agreement with Veterans Affairs to conduct AWG hearings on Agriculture's behalf.

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<sup>28</sup>According to Agriculture, certain agency debts are exempt from cross-servicing. For example, Food Stamp Program debts are held by the states, which Agriculture considers to be third parties. These debts are serviced and/or collected by third parties, and thus are exempt from the requirement to transfer to Treasury for cross-servicing by 31 CFR 285.12. Agriculture plans to analyze these debts to see if the AWG process is doable and feasible economically as many such debts involve very low dollar amounts. Agriculture intends to determine the feasibility of using AWG to collect Food Stamp Program debt by December 2002. Currently, Agriculture is surveying its component agencies to identify other types of debt that may be exempt from cross-servicing.

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## Treasury's Debt Collection Improvement Account Has Not Been Activated

DCIA includes a voluntary "gainsharing" provision that allows agencies to deposit a limited and defined portion of their debt collections into a special fund account maintained and managed by Treasury. The law provides that deposits into the special fund are available to the Secretary of the Treasury for gainsharing purposes only in amounts provided in advance in appropriations acts.<sup>29</sup> The Secretary may make payments from amounts appropriated to agencies for purposes related to credit management, debt collection, and debt recovery.<sup>30</sup> However, because collections are routinely deposited into the general fund of the Treasury, appropriations would be required in order to implement this incentive provision.

Treasury has established a debt collection improvement account that can be activated if its appropriations authorize the expenditure.<sup>31</sup> To date, only the Small Business Administration (SBA) has requested funding for gainsharing through Treasury's debt collection improvement account. Based on SBA's requests, Treasury's appropriation requests for fiscal years 1998 and 1999 included language for funding the debt collection improvement account for up to \$384,000 and \$3 million, respectively. However, the Congress made no amounts available in Treasury's appropriations to fund the account.

According to Treasury, because the debt collection improvement account has never been utilized, it is difficult to assess how effective the account

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<sup>29</sup>Agencies may contribute amounts equal to 5 percent of their collections in a fiscal year less their baselines, which are generally 5 percent of their collections in the previous year or 5 percent of their average annual amounts collected in the previous 4 years, whichever is greater. OMB in consultation with Treasury may adjust an agency's contribution amount to reflect the level of effort in credit management by the agency. An indicator of this effort is based on two factors: (1) the number of days between a debt being delinquent and referral to Treasury for collection (or an exemption from referral obtained) and (2) the ratio of delinquent debts to total receivables for a given program and the change in the ratio over a period of time. The amounts agencies transfer to Treasury's debt collection improvement account would be available to reimburse the agencies only to the extent and in amounts provided in advance by Treasury's appropriations.

<sup>30</sup>Credit management, debt collection, and debt recovery expenses cover activities such as account servicing, data processing equipment, delinquent debt collection, measures to minimize delinquent debt, sales of delinquent debt, asset disposition, and training of personnel involved in credit and debt management.

<sup>31</sup>The account is the Gainsharing Receipts Debt Collection Improvement Account, which is a receipt account that has been established by Treasury in accordance with OMB procedures. Treasury's FMS would monitor and manage the account for administrative purposes and record the gainsharing funds for each agency.

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could be in enhancing federal agencies' debt collection or what changes, if any, should be made in the financial incentive area to improve debt collection governmentwide.

Although the effectiveness of DCIA's gainsharing provision cannot be fairly assessed at this time, it is important that the provision be kept in proper perspective relative to the overall effectiveness of DCIA in improving the federal government's debt collection efforts. DCIA contains specific requirements for federal agencies to improve collection of their nontax debts, namely referral of certain delinquent debts to Treasury for centralized collection. While the pace of implementation has been slow, and collection opportunities have been lost, progress is being made.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you or other Members of the Subcommittee may have.

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