

DOCUMENT RESUME

05958 - [R1366368]

Need To Improve Servicing of Direct Loans under the Business Development Assistance Program. FGMSD-78-34; B-189572. May 15, 1978. 3 pp. + 2 appendices (11 pp.).

Report to Robert T. Hall, Department of Commerce: Assistant Secretary for Economic Development; by D. L. Scantlebury, Director, Financial and General Management Studies Div.

**Issue Area: Accounting and Financial Reporting: Collection of Amounts Owed (2803); Accounting and Financial Reporting: Internal Controls over Receipts and Disbursements (2810).
Contact: Financial and General Management Studies Div.
Budget Function: Miscellaneous; Financial Management and Information Systems (1002).
Organization Concerned: Economic Development Administration.**

The Economic Development Administration (EDA) attempts to create permanent jobs in high unemployment areas by assisting businesses to expand or locate new facilities in affected areas. The assistance includes direct loans and guarantees of loans with private lending institutions and is administered primarily through six regional offices. Loan servicing is undertaken by regional offices to assure loan repayment and detect weaknesses in the borrower's repayment ability. Findings/Conclusions: As of June 30, 1977, EDA had about \$306 million receivable on 439 loans and a contingent liability of \$148 million on 46 loan guarantees. At that date, 29% of the loans outstanding were in arrears or renegotiated. This percentage could be reduced if loan servicing were improved to correct the following shortcomings: a large proportion of borrowers were not promptly contacted when repayments were late; field visits to borrowers were infrequent in spite of procedures which emphasize this activity; borrowers' financial statements were not regularly obtained and analyzed; and management and technical assistance was seldom offered to borrowers in difficulty. EDA officials stated that inadequate loan servicing resulted from greater emphasis on new loan application approval than on loan servicing. Recommendations: Regional offices should be required to: make better use of the information which identifies delinquent borrowers and plan appropriate followup action, place greater emphasis on making regular visits to borrowers, provide management and technical assistance to borrowers as needed, and obtain borrowers' quarterly and annual financial statements and assure that the statements are analyzed promptly. (Author/HTW)

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REPORT BY THE U.S.

General Accounting Office

Need To Improve Servicing Of Direct Loans Under The Business Development Assistance Program

About \$89 million, or 29 percent, of the Economic Development Administration, Department of Commerce, outstanding loans are in arrears or have had to have renegotiated terms because the loan had been in arrears. The Agency could increase assurance that business loans will provide lasting benefits and the Government's financial investment will be recovered by improving its loan servicing and management assistance to borrowers.

It needs to:

- make better use of available information which identifies delinquent borrowers,
- place greater emphasis on field visits to borrowers,
- obtain and promptly analyze borrowers' financial statements to identify existing or potential problems, and
- provide management and technical assistance.





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

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-169572

The Honorable Robert T. Hall
Assistant Secretary for Economic
Development
Department of Commerce

Dear Mr. Hall:

This report discusses the need for improvements in financial management and loan servicing of the Economic Development Administration's (EDA's) Business Loan and Guarantee Program. The need for improved financial controls over EDA's business loan guarantee program, which we also reviewed, will be discussed in another report.

EDA attempts to create permanent jobs in high unemployment areas by assisting businesses to expand or locate new facilities in affected areas. The assistance includes direct loans and guarantees of loans with private lending institutions, and is administered primarily through six regional offices. As of June 30, 1977, EDA had about \$306 million receivable on 439 direct loans and a contingent liability of \$148 million on 46 loan guarantees.

Loan servicing consists of activities taken by regional offices to assure the repayment of funds loaned by EDA. An important objective of loan servicing is to detect early weaknesses in the borrower's repayment ability. EDA can then take corrective actions to increase the chances that business loans will provide lasting benefits and recoup the Government's financial investment.

We believe that if loan servicing were improved, fewer loans would be in arrears or renegotiated. As of June 30, 1977, 29 percent of the approximately \$306 million in loans outstanding were in this status.

We identified the following shortcomings in the loan servicing activities.

- Borrowers were not promptly contacted when repayments were late. Of the borrowers who made late payments, 54 percent said EDA never contacted them; an additional 23 percent said they were not contacted until after the payments were 15 days overdue.
- Field visits to borrowers were infrequent, although EDA's procedures state that carrying out an effective field visit is considered the most important loan servicing activity. Forty-six percent of the borrowers said an EDA representative had not visited them more than once--usually not at all--during a recent 2-year period.
- Borrowers' financial statements were not regularly obtained and analyzed. Eleven percent of borrowers reported they did not submit required statements to EDA.
- Management and technical assistance was seldom offered to borrowers in difficulty. Thirteen percent of borrowers said they had a need for nonfinancial assistance.

According to EDA officials, a major reason for the inadequate loan servicing has been the concentration of personnel resources on new loan application approval and less emphasis on loan servicing. We believe that by placing greater emphasis on loan servicing, EDA could better preserve the jobs created and be more effective in assuring loan repayment.

We recommend that you require each regional office to

- make better use of the information which identifies delinquent borrowers and plan appropriate followup action,
- place greater emphasis on making regular visits to borrowers,
- provide management and technical assistance to borrowers as needed, and
- obtain borrowers' quarterly and annual financial statements and assure that the statements are analyzed promptly.

B-189572

Details of the problems in loan servicing and on the corrective actions needed are discussed in appendix I.

We have informally discussed our findings, conclusions, and recommendations with agency officials, and their views have been included in the report where appropriate. We are also sending a copy of this report to the Director, Office of Audit, Department of Commerce. We appreciate the courtesies and cooperation extended to our representatives during the review.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. L. Scantlebury". The signature is written in a cursive style with a long horizontal stroke at the end.

D. L. Scantlebury
Director

NEED TO IMPROVE SERVICING OF DIRECT LOANSUNDER THE BUSINESS DEVELOPMENT ASSISTANCE PROGRAMBACKGROUND

The Economic Development Administration (EDA), Department of Commerce, assists private industry to expand or locate new facilities in areas burdened by high unemployment or low family income. As of June 30, 1977, EDA had over \$306 million receivable on 439 direct loans and a contingent liability of over \$148 million on 46 loan guarantees.

Before prospective borrowers can obtain EDA financial assistance, they must show that assistance is not available from other sources. The assistance consists of

- working capital loans or guarantees,
- fixed asset loans or guarantees, and
- building and equipment lease payment guarantees.

To administer business development assistance, EDA maintains six regional offices:

- Atlantic, located in Philadelphia, Pennsylvania.
- Southeastern, located in Atlanta, Georgia.
- Midwestern, located in Chicago, Illinois.
- Southwestern, located in Austin, Texas.
- Rocky Mountain, located in Denver, Colorado.
- Western, located in Seattle, Washington.

Each regional office has a Business Development Division responsible for making and servicing loans.

Loan servicing, as a method of assuring that loans are repaid, should be undertaken by regional offices. Loan servicing is emphasized so that weaknesses in the borrower's ability to repay its debt can be promptly detected and corrected to minimize EDA's financial risk.

LOAN SERVICING NEEDS IMPROVEMENT

EDA could increase the chances that business loans will provide lasting benefits and recoup its financial investment by improving its loan servicing and management assistance efforts. According to EDA regional officials, loans have not been serviced adequately because of staff shortages and the processing of new loan applications has been emphasized. These officials also said they are reluctant to use their technical assistance funds and they rarely make them available to borrowers.

We believe that because of the preceding conditions, EDA has more loans than need be--\$89.1 million--in arrears or that had to be renegotiated. As of June 30, 1977, the principal payments on these loans were suspended, reduced, or overdue, or the borrowers' assets were being sold to pay the debt. The following table shows, for each region, the total amount of loans outstanding and the amount of loans in arrears or renegotiated.

| <u>Loans in Arrears or Renegotiated</u> | | | |
|---|--------------------------------|---------------|-------------------------|
| <u>Region</u> | <u>Total loans outstanding</u> | <u>Amount</u> | <u>Percent of total</u> |
| | (millions) | | |
| Atlantic | \$ 92.1 | \$24.1 | 26 |
| Southeastern | 85.0 | 24.9 | 29 |
| Western | 50.1 | 11.1 | 22 |
| Southwestern | 38.5 | 5.8 | 15 |
| Midwestern | 32.3 | 18.3 | 57 |
| Rocky Mountain | <u>8.6</u> | <u>4.9</u> | 57 |
| | <u>\$306.6</u> | <u>\$89.1</u> | 29 |

As part of our review, we sent a questionnaire to the 401 EDA direct loan and guarantee recipients as of December 31, 1976; 306 responses were received. (See app. II for further details.) We verified the questionnaire responses in the Southeastern and Midwestern regions by interviewing regional officials and examining regional office records on a test basis. We did not verify the questionnaire responses to the Atlantic regional office records but interviews with regional officials and other work confirmed that similar conditions existed.

We identified the following shortcomings in loan servicing by regional offices:

- Borrowers were not contacted promptly when reports from EDA's centralized accounting system showed repayments were late.
- Field visits to borrowers were infrequent.
- Borrowers' financial statements were not regularly obtained and analyzed.
- Management and technical assistance was seldom offered to borrowers in difficulty.

BORROWERS NOT PROMPTLY CONTACTED
CONCERNING LATE REPAYMENTS

Over half of EDA's borrowers who were late in making payments said they were not contacted. We believe prompt followup by EDA officials would speed loan repayments and provide greater assurance that the loan would be repaid.

Even though all billing and accounting for loans is handled by EDA's centralized Accounting Division in Washington, D.C., regional offices follow up on delinquent payments. The Accounting Division normally bills borrowers 10 days before the repayment due date. Late payment notices were mailed 10 days past the due date. But, this practice was stopped in 1977. Now the only notice of overdue payment is on the next month's bill. A copy of the bill is also to be sent to the regional office responsible for servicing the loan. Upon receiving the notice of late payment, the loan servicing officer who monitors the loan is required to call the borrower to determine the reason for the delay and when payment will be made.

Commercial bank representatives, whom we contacted, stated that it is their policy to contact borrowers within a couple of days after a missed payment and on a continuing basis thereafter until payment is remitted. These representatives believed that the sooner a borrower who misses a payment is contacted, the more likely the borrower will make payment.

Eighty-four borrowers, or 27 percent, of those who responded to the questionnaire, said they were occasionally late in making payments. We verified questionnaire responses

on a test basis to EDA records maintained by the Southeastern and Midwestern regions and found them to be consistent. Suitable records were not maintained by the Atlantic region to permit verification of questionnaire data.

Of the borrowers who reported making late payments:

--54 percent said they were not contacted by EDA.

--23 percent said they were contacted by EDA, but not within 15 days after the payment due date.

--23 percent said they were contacted by EDA within 15 days after missing a payment.

EDA needs to promptly contact borrowers with late payments.

INFREQUENT FIELD VISITS TO BORROWERS

Although EDA requires visits to borrowers at least once annually, we found this requirement was not being fully met.

EDA procedures require regional office representatives to visit all borrowers annually. The procedures state that an effective field visit is the most important loan servicing activity. Similarly, commercial banks try to be aware of their borrowers' financial situation. Bank representatives said they want to know immediately about business problems that borrowers may be experiencing, and this requires representatives to make frequent visits to borrowers. Bank representatives said that annual visits would be the minimum requirement--even for borrowers in a current repayment status with no obvious business problems.

When asked about field visits, 143 borrowers, or 46 percent of those responding to the questionnaire, said that they had not been visited by an EDA representative more than once--usually not at all--during the 2 years ended December 31, 1976. The following table shows, for each region, the percentage of borrowers receiving not more than one EDA visit during the 2-year period compared with the percentage of total loans in a noncurrent repayment status at June 30, 1977.

| <u>Region</u> | <u>Percent of borrowers receiving not more than one field visit within 2 years</u> | <u>Percent of loans in arrears or renegotiated</u> |
|----------------|--|--|
| Atlantic | 63 | 26 |
| Southeastern | 54 | 29 |
| Rocky Mountain | 56 | 57 |
| Midwestern | 40 | 57 |
| Western | 30 | 22 |
| Southwestern | 24 | 15 |

For the last four regions in the preceding table, there appears to be some relationship between the lack of annual field visits and the relatively high percentage of loans in arrears. For the largest two regions, Atlantic and Southeastern, although there is no apparent relationship, we believe that the size of the loans in arrears \$24.1 million and \$24.9 million, respectively, would indicate the need for more intensive loan servicing to include frequent field visits.

The Atlantic region had the highest percentage of borrowers reporting not more than one EDA visit in 2 years. Regional office records provided the following statistics which further demonstrate the infrequency of field visits.

- For borrowers who were in arrears at June 30, 1976, the average interval between visits was slightly over 2 years, exclusive of three borrowers who had never been visited.
- For borrowers with a loan in liquidation at June 30, 1976, the last visit was made an average of 1.5 years before the liquidation date or transfer for intensive servicing.
- For borrowers who were in arrears at June 30, 1976, the first visit was made an average of 2.6 years after the loan had been disbursed.

EDA's Loan Administration Division, to which all of the regional business development divisions report, has done a series of semiannual studies on field visits. The first study, from July 1 to December 31, 1974, stated that only a few regional offices, as measured by field visit activity, were actively servicing their business loan portfolios and, as a whole, loan servicing was apparently not being properly performed. Subsequent studies added support to the EDA evaluations made in the original report.

The Loan Administration Division also observed a possible general trend in which regions showing below-average field visit activities experienced an above-average number of borrowers in difficulty. The studies further stated that there appears to be at least some direct, although general, relationship between lack of field visits and the number of loans that are past due and in liquidation. We believe that EDA representatives should make at least the required annual field visits.

BORROWERS' FINANCIAL STATEMENTS
NOT REGULARLY OBTAINED AND ANALYZED

The value of obtaining and analyzing borrower financial statements by EDA is diminished when appropriate followup action is not taken. Once potential or actual problems are identified, visits could be useful to discuss such problems and reach an agreement on corrective actions to be taken.

EDA procedures state that analysis of borrowers' financial statements is an important part of loan servicing because it allows EDA to follow closely its borrowers' financial progress. Financial statement analysis enables loan servicing officers to determine significant trends in a borrower's business, whether borrowers are complying with terms of their loan agreements and whether borrowers' projections are in accord with or vary significantly from actual operating and financial results. Analysis should allow loan servicing officers an opportunity to discuss problem areas with borrowers in a timely manner. EDA procedures require borrowers to furnish quarterly statements and yearend audited statements.

In response to our questionnaire, 32 borrowers (11 percent of those responding) said they did not submit periodic financial statements to EDA. The range for the regional offices was 18 percent in the Atlantic region to 3 percent in the Southwestern region. Further, 38 borrowers (14 percent of those responding) said EDA did not request financial statements when the borrowers did not submit statements regularly. The range was 23 percent in the Atlantic region to 3 percent in the Southwestern region.

Atlantic regional records showed that:

--Of 12 borrowers who were delinquent in repayments as of June 30, 1976, only 4 had submitted financial statements for 1975 (2 were unaudited). The last annual statements submitted by the other 8 borrowers

were for 1974 or earlier. Quarterly statements were received inconsistently.

--Of four borrowers with loans that went into liquidation in 1975, one last submitted annual statements (unaudited) for 1974; and three last submitted annual statements for 1973 (one unaudited). Another borrower with a loan in liquidation on June 30, 1976, had never submitted annual statements. Quarterly statements were not received on a regular basis.

We observed, at the three regional offices visited, that numerous financial statements from borrowers had not been analyzed. Regional representatives said that the Business Development Divisions were too busy working on new loan applications to analyze all statements received. The same reason was given for not always requesting statements from borrowers who failed to submit them.

MANAGEMENT AND TECHNICAL ASSISTANCE SELDOM OFFERED TO BORROWERS IN DIFFICULTY

By providing management and technical assistance to needy borrowers, EDA could increase assurance that business loans would provide lasting benefits and its financial investment will be recovered. Some of EDA's borrowers who encounter difficulty do not have the expertise or resources to solve their own problems. They may be new businesses which have a real need for management and technical advice and constructive recommendations.

EDA procedures state that management and technical assistance should be provided to borrowers in difficulty but do not specify the type of assistance. According to EDA officials, loan servicing officers decide the type of assistance needed and how it should be provided. For example, EDA can offer the services of its personnel to help borrowers resolve problems or can provide technical assistance funds for borrowers to engage consultants.

Forty-one of the borrowers who responded to the questionnaire (13 percent) said they had a current need for nonfinancial assistance in one or more areas, such as management, marketing, and resolving technical problems.

EDA regional and headquarters officials told us that present procedures prevent EDA's expeditious delivery of management and technical assistance to borrowers. Moreover,

even the availability of such assistance is hampered by contracting delays. Accordingly, EDA officials are reluctant to attempt to use its technical assistance funds and often do not make the availability of such assistance known to borrowers.

In some instances, EDA has requested the Small Business Administration's (SBA's) help in contracting for and/or obtaining management and technical assistance for EDA borrowers.

We believe EDA should consider developing ways of providing management assistance to borrowers. This could be done by developing its own counseling program, streamlining its delivery capabilities, or arranging for other organizations and groups to provide this service.

For example, the SBA has an assistance program available to SBA and non-SBA borrowers. On June 30, 1976, SBA employed about 320 management assistance counselors. Most of the counseling sessions conducted by SBA and its consultants were with non-SBA borrowers.

An SBA official confirmed that the following management assistance is available to EDA borrowers:

- Service Corps of Retired Executives (SCORE). An organization of retired business executives who volunteer their services to help small business owners solve their problems.
- Active Corps of Executives (ACE). An organization of volunteers--active executives in industry, trade associations, educational institutions, and the professions.
- Small Business Institute (SBI). A program which provides faculty-supervised management counseling to small businesses by university graduate and undergraduate students.
- The Call Contract Program. This program employs consultants to provide management and technical assistance to small business owners who are eligible under the Economic Opportunity Act of 1964.
- The Professional Association Program. Under this program members of professional associations, such as the National Association of Accountants, provide management and technical assistance to small businesses on a voluntary basis.

EDA should ensure that borrowers receive necessary management and technical assistance. The assistance can be provided by either EDA or another organization, such as SBA.

CONCLUSIONS

EDA has not adequately serviced its loans, especially borrowers who are delinquent in their repayments. Although EDA's Accounting Division informs the regional offices of overdue payments, the information has not been used effectively. Field visits to borrowers have been infrequent, yet EDA studies show an apparent relationship between a lack of visits and loans in trouble. Our review also showed that there is an apparent relationship between field visits and the status of loan repayments.

EDA has not always been able to detect adverse financial trends in borrowers' operations because borrowers' financial statements have not been obtained and analyzed on a regular basis. Some borrowers need management and technical assistance, but EDA has been reluctant to provide staffing or funds.

Major reasons for the inadequate loan servicing, according to EDA officials, have been EDA's concentration of personnel resources on new loan application approval and placing a lower priority on loan servicing, as well as the detail of loan servicing personnel to local public works and drought assistance programs.

A primary objective of EDA loans is to finance enterprises which provide jobs in areas having high unemployment. These benefits are lost when borrowers experience serious financial difficulties and can no longer operate profitably. By placing greater emphasis on loan servicing, EDA could better preserve the jobs that loans were intended to create and also be more effective in assuring loan repayment.

RECOMMENDATION

To increase the effectiveness of loan servicing, we recommend that the Assistant Secretary for Economic Development require each regional office to

- make better use of the information provided by headquarters, which identifies delinquent borrowers and plan appropriate followup action;
- place greater emphasis on making regular visits to borrowers;

- assure that management and technical assistance is provided to borrowers as needed through either EDA or another organization, such as SBA; and
- obtain borrowers' quarterly and annual financial statements and assure that the statements are analyzed promptly.

QUESTIONNAIRE

We developed a questionnaire to obtain information from loan recipients regarding EDA loan servicing. The questionnaire was sent to the 401 loan recipients as of December 31, 1976; 306 responses were received. The questionnaire contained requests for information on various aspects of EDA's loan servicing, including followup on late loan payments, field visits to borrowers, requirements for financial statements, and management and technical assistance furnished to borrowers. Questionnaire responses were verified by EDA regional office records on a selective basis.

| <u>Region</u> | Number of questionnaires <u>sent</u> | <u>Number of responses</u> | Response rate (percent) |
|----------------|--|--------------------------------|-----------------------------------|
| Atlantic | 113 | 84 | 74.3 |
| Southeastern | 95 | 71 | 74.7 |
| Midwestern | 63 | 47 | 74.6 |
| Southwestern | 56 | 41 | 73.2 |
| Rocky Mountain | 19 | 16 | 84.2 |
| Western | <u>55</u> | <u>47</u> | 85.5 |
| | <u>401</u> | <u>306</u> | 76.3 |

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