GAO United States
General Accounting Office

Memorandum

Date: August 8, 1989

To: Assistant Director, AFMD/AFA - Louise Summersett

Thru: Assistant General Counsel, OGC/AFMD - Jeffrey A. Jacobson

From: Attorney-Advisor, OGC/AFMD - Douglas H. Hilton

Subject: Audit of Farmers Home Administration's Financial Statements for Fiscal Year 1988 (Code 917108; B-235577)

On May 9, 1989, your staff requested our opinion on whether three credit management practices of the Farmers Home Administration (FmHA) should be included in GAO's report on FmHA's compliance with laws and regulations. Specifically, your staff asked whether the report on compliance should report as violations:

(1) FmHA's failure to report to the Internal Revenue Service (IRS) when debts owed to FmHA are discharged, so that taxes on the resulting discharge of indebtedness income could be collected;

(2) FmHA's failure to assess administrative fees and penalties against debtors who default on their payments to FmHA; and

(3) FmHA's failure to use private collection firms to collect defaulted payments.

For the reasons stated below, it is our view that none of these matters should be included in the report on FmHA's compliance with laws and regulations as a violation of a legal requirement.

BACKGROUND

The FmHA is an agency within the U.S. Department of Agriculture which provides financial and technical assistance to individuals, businesses, and communities in

agricultural and rural areas of the U.S. FmHA provides financial assistance (by making direct loans and guaranteeing loans made by other lenders) for farm ownership and operation, housing, water and waste systems, and community facilities. The consolidated Statement of Financial Position for FmHA shows that as of September 30, 1988, $39 billion of FmHA's total $45 billion in assets were loans receivable FmHA held as a result of these loan and loan guarantee programs.

The Debt Collection Act, 31 U.S.C. §§ 3711 - 3719, authorizes and requires the heads of executive and legislative agencies to take certain actions in collecting and compromising claims of the United States. Section 3711(e)(2) authorizes the Attorney General and the Comptroller General to jointly prescribe standards controlling the actions of the agency heads. These Federal Claims Collection Standards are found at 4 C.F.R. Chapt. II.

On November 25, 1988, the Office of Management and Budget issued its revised Circular A-129, "Managing Federal Credit Programs." The circular "prescribes policies and procedures for managing Federal credit programs and sets standards for extending credit, managing credit through servicing and/or selling of loan assets, collecting delinquent debt, and writing off uncollectible debt." The circular states that it applies to direct loan programs and guaranteed loan programs.

Your staff has asked for our opinion on whether GAO should report three loans receivable management practices of FmHA as violations of either The Debt Collection Act, the Federal Claims Collection Standards, or OMB Circular A-129. The three practices are FmHA's failure to report to the IRS when debts are written off, FmHA's failure to assess late payment penalties or administrative charges on delinquent debts, and FmHA's failure to use private collection firms to collect debts.

LEGAL ANALYSIS

Reporting to the IRS When Debts Are Written Off

The discharge of indebtedness by a creditor generally represents taxable income to the debtor. 26 U.S.C. § 61(a)(12). Thus when the Federal government writes off debts that are owed to it, it may also become entitled to income taxes from the debtor. To help collect these taxes, OMB Circular A-129 states on page 41 that "[a]gencies shall report to IRS any written-off debt not discharged through bankruptcy . . . ." The report is made on IRS Form 1099-G,

"Statements for Recipients of Certain Government Payments." In December of 1986, and again in 1987, the Administrator of FmHA made a decision not to report FmHA debt write offs to the IRS.

Although OMB Circular A-129 contains the directive that agencies "shall report" debts written off, OMB is not vested with any statutory authority to issue regulations governing the debt write-off practices of Federal agencies. In B-203240-O.M., May 27, 1982, our office examined a prohibition contained in another OMB Circular, A-70, "Legislation on Federal Credit Programs" (currently entitled "Policies and Guidelines for Federal Credit Programs"). There we stated that "[e]xecutive orders, directives, or regulations that are not specifically authorized by statute and which are essentially directed at ensuring the efficient operation of the executive branch are matters of executive policy and do not have the force and effect of law." Since the requirement to report debts written off to the IRS in Circular A-129 is not specifically authorized by a statute, it is only a matter of executive branch policy. We note that OMB itself has acknowledged to FmHA that there is no legal requirement to report the debt write offs to IRS.

Given that there is no legal requirement and OMB and FmHA are continuing to discuss the issue of FmHA's adherence to the executive branch policy, we believe that this issue should not be characterized as a violation of a legal requirement in the report on FmHA's compliance with laws and regulations. However, since FmHA's practice does conflict with the executive branch policy contained in A-129, we have no objections if you wish to inform the Congress in the reports or the management letter resulting from this audit that FmHA is not following OMB's policy.

Assessment of Late Payment Penalties and Administrative Fees on Delinquent Debts

Section 11(e) of the Debt Collection Act, 31 U.S.C. § 3717(e), provides that agencies shall assess charges to cover the cost of processing and handling a delinquent debt, and a six percent per year penalty charge on debt payments which are more than 90 days past due. GAO's management letter to FmHA after the completion of the fiscal year 1987 audit pointed out that FmHA is not assessing these administrative costs or late payment penalties. However, section 11(g)(1) of the act, 31 U.S.C. 3717(g)(1), provides that the interest and penalty provisions of section 11 do not apply where "a statute, regulation required by statute, loan agreement, or contract prohibits charging interest or assessing charges or

explicitly fixes the interest or charges." We examined 31 U.S.C. § 3717 (g)(1) in 66 Comp. Gen. 512 (1987) which concluded that a statute which provided for the collection of interest and administrative charges on late payments to the Veterans Administration precluded charging penalties under the Debt Collection Act. 66 Comp. Gen. at 513. We stated that "[s]ince the VA statute prescribes all financial charges to be assessed against its debtors from the time the debt first accrues to the date of payment, there is no room for the application of different assessments under the Debt Collection Act." Id. at 514-515.

We examined samples of the promissory notes FmHA uses for its loans (Forms FmHA 1940-16, 1940-17, 1940-18, and 440-22). All of the notes provide that interest accrues until the principle amount of the note is paid. Two of the notes provide that interest which is more than 90 days past due is capitalized and accrues interest at the rate specified on the note. Three of the notes provide that any administra- tive costs of the FmHA for the collection of the notes becomes, at FmHA's option, part of the principle balance of the loan. One note provides that the borrower agrees to pay "late charges" in accordance with FmHA's regulations. None of the notes are silent on whether a debtor is liable for additional charges as a result of not making timely payment on the note.

Thus, like the statute construed in 66 Comp. Gen. 513, these promissory notes prescribe all of the financial charges FmHA's debtors must pay until the final date of payment, including assessing either administrative costs of collection, additional interest for late interest payments, or "late charges." Therefore, under the terms of 31 U.S.C. § 3717(g)(1), the interest and penalty provisions of the Debt Collection Act do not apply to the debts represented by the promissory notes. Since this issue has already been raised with FmHA, and since the terms of FmHA's loan agreements preclude the application of the administrative cost and penalty provisions to many of FmHA's current loans, we believe this issue should not be included in GAO's report on FmHA's compliance with laws and regulations or in any other report to FmHA based on this audit.

Use of Private Debt Collection Agencies

OMB Circular A-129 states on page 34 that "all accounts that are six months or more past due must be turned over to a collection contractor . . . ." Your staff has noted that FmHA did not refer any accounts to private collection contractors during fiscal year 1988. However, the Debt Collection Act, which provides agencies with general

authority to contract for debt collection, states that "[u]nder conditions the head of an executive or legislative agency considers appropriate, the head of the agency may make a contract with a person for collection services to recover indebtedness owed the United States Government." 31 U.S.C. § 3718 (emphasis added). Thus, the mandatory statement in the OMB Circular is not based on any statutory authority given to OMB and is not legally binding. Moreover, the discretionary authority to contract for debt collection is specifically vested in the head of the agency concerned. In our view, the fact that FmHA has not exercised its statutory discretion to contract for debt collection is not an appropriate issue for GAO's report on FmHA's compliance with laws and regulations.

CONCLUSION

We do not believe that the three issues raised by your staff in the audit of the FmHA's financial statements for fiscal year 1988 should be included in GAO's report on FmHA's compliance with laws and regulations as noncompliance with legal requirements. First, although FmHA is not reporting to the IRS when FmHA debts are written off, the requirement to do so in OMB Circular A-129 is only executive branch policy rather than a legal requirement. We have no objections to disclosing this matter to the Congress so long as the disclosure makes clear that a violation of a statute or regulation is not involved. Second, FmHA has in large part not assessed late payment penalties and administrative costs in accordance with section 11 of the Debt Collection Act. However, FmHA's loan agreements provide FmHA a basis to collect similar amounts, and the Act's late payment and administrative charge provisions do not apply when loan documents assess those charges. Finally, although FmHA has not contracted with private debt collection firms to collect its delinquent debts, the authority to enter into those contracts is discretionary, and FmHA's failure to follow the policy in OMB Circular A-129 does not violate any legal requirement.

cc: Mr. Hinchman, OGC
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DIGESTS:

1. The requirement in Office of Management and Budget Circular A-129 that federal agencies report to the Internal Revenue Service when any debts owed to the United States is written off is only an executive branch policy requirement and not a legal requirement. The Farmers Home Administration did not violate a law or regulation by failing to report debt write-offs to the IRS.

2. Farmers Home Administration loan agreements, which provide for collection of additional interest, costs of collection, other late charges when loan payments are late, preclude the application of late payment penalties and interest charges under the Debt Collection Act.

3. Agency authority under the Debt Collection Act to contract for private collection firms is discretionary. The Farmers Home Administration does not violate the Debt Collection Act by failing to contract with debt collection firms.