AN OVERVIEW BY THE LEGISLATIVE AUDITOR
OF THE FINANCIAL AUDIT OF THE
LOAN AND GRANT PROGRAMS OF THE DEPARTMENT OF AGRICULTURE

INTRODUCTION

The financial audit of the loan and grant programs of the department of agriculture (DOA) identifies numerous deficiencies in the administration and operations of the farm loan program. Many of these deficiencies were reported in our 1971 audit of the department, and we find that some of the problems still exist. The audit was conducted jointly by the office of the legislative auditor and the firm of Coopers & Lybrand, certified public accountants.

On February 16, 1978, following our usual practice, we transmitted a copy of our preliminary draft of this audit to the department and requested that the board of agriculture submit in writing by February 27, 1978 its comments on the audit recommendations, including information on the specific actions that have been taken or will be taken with respect to the recommendations. At the request of the chairman of the board of agriculture, two meetings were held to discuss the report. On March 11, 1978, DOA transmitted its response to our office. As seen in Part III, "Comments on Agency Response," DOA responded by suggesting extensive changes to our report. Generally, the department wanted to substitute findings and discussion critical of current practices with language of a less critical nature. As indicated in our comments to the department's response, we do not agree with the changes suggested by the department or its justifications, and our final report is basically as originally written.

This overview summarizes our major findings and recommendations.

SUMMARY OF MAJOR FINDINGS

Declining Participation of Private Lenders

By statute, the farm loan program is intended to encourage commercial lending institutions to participate with the State in making loans to farmers and to insure loans made by these private lenders and the federal government. However, in those instances where farmers are unable to obtain sufficient funds at reasonable rates from private lenders, either independently or under the participation loan or insured loan programs or the Farmers Home Administration, the law provides that the department may grant direct state loans. The audit disclosed that, while emphasis appeared to have been given to stimulating financing by private sources in the early 1960's, today, loans from the private sector play but a miniscule and declining rôle in the State's farm loan program. In 1962–63, 63.5 percent of all loans were participation loans by private lenders, whereas by 1968–69, only 24.7 percent were participation loans. On June 30, 1975, participation loans constituted 13.7 percent of all loans outstanding versus 86.3 percent in direct state loans. The department admits that "the bulk of all state loans are now direct loans." It is not possible to conduct a viable agricultural credit program which relies almost solely on state government funds.

The DOA's Subsidy Approach to the Farm Loan Program

DOA considers the farm loan program as a subsidy rather than as a loan program. This is evidenced by the practice of the department in making loans to farmers of very poor credit risk and on inadequate security. In addition, while loans are meant to be repaid, the department makes little effort to enforce payment of past due accounts; instead, the department refinances the loans, even when the farmers are financially insolvent.

Loans to poor credit risks. In making loans to farmers, the department does not fully consider whether the borrower has the capability to repay the money borrowed. It has granted loans even when the applicant's income projections have shown insufficient cash flow to repay the loan. Loans have also been made when an applicant already has a string of outstanding delinquent loans and his financial statements indicate insolvency, i.e., when the farmer's total debt exceeds his total assets. Considering DOA's loan-making practices, it is not surprising that the amount of the delinquencies has nearly doubled since 1972. At June 30, 1976, delinquencies amounted to $3.6 million or about 36 percent of the total $9.6 million in loans outstanding.

Inadequate security. The law requires that all farm loans made by DOA be secured by first mortgages on certain kinds of property located in the State. The purpose of the security requirement, of course, is to assure that the debt will be repaid in the event the borrower defaults in the repayment of his loan. The audit disclosed that DOA, in its efforts to aid debt-ridden farmers, has jeopardized its security position. It has accepted as security such property as shares of stock in a farm corporation, which, under the law, is unacceptable. In addition, it has accepted as security property having insufficient value in relation to the amount of the loan.

Nonenforcement of repayments. The department has done little to enforce repayments of loans, even in those cases where loans have been past due for more than four years. Since 1959, there has been only one instance of foreclosure, even though delinquencies have been substantial. Instead, it readily grants refinancing and consolidation loans when farmers fall behind in the repayment of existing loans and there is little hope that the new and the existing loans will ever be repaid. Moreover, DOA utilizes the techniques of refinancing and debt consolidation in a way which can even be detrimental to the farmer.

Generally, under accepted and customary commercial lending practices, refinancing loans are for an amount equal to the existing debt (plus accrued interest), while consolidation loans are for an amount equal to the amount of the principal balance (plus accrued interest). Additional amounts over and beyond the debt to be refinanced or consolidated may be loaned, but only where the financial circumstances of the borrower justify such additional amounts.

Under DOA's refinancing and consolidation practices, only that portion of an existing debt which is past due, and not the entire loan amount, is refinanced. Because the new loan covers only the delinquent amount, the existing loan is not cancelled but continues in effect. Then, additional monies beyond the amount needed to cover the delinquencies are loaned. As the repayments on the old loan and new loan become delinquent, another refinancing or consolidation loan is made. This continues until the farmer no longer has assets to pledge as security for loans. Thus, the farmer's economic plight could be worsened.

Concentration of Loans in a Handful of Farmers

DOA's refinancing practices have resulted in the farm loan program benefiting but a handful of farmers, whereas the program is intended to assist a large number of farmers. The audit revealed that, at June 30, 1975, 85 or 12.9 percent of the 661 farmers participating in the farm loan program had nearly one half of the amount in loans, i.e., $4.3 million of the total $8.9 million. The average loan amount for this group of 85 was $50,548, as compared to the average loan amount for the total 661 farmers of $13,438. We conclude that the program's benefits have been limited to a few, contrary to legislative intent that "all available farm loans should be spread among reasonably efficient farmers rather than concentrated among a few."

CONCLUSION

If the farm loan program is to remain a loan program, then efforts and activities of DOA will need to be reoriented. The lax practices relating to qualification for loans and security to be posted will need to be tightened so that there is reasonable assurance that loans will be repaid, and if not repaid, that the State will be able to recover all or most of the outstanding loan amount. To reduce the high rate of loan delinquencies, the department needs to monitor and pursue its past due accounts, and it must cease making those types of refinancing and consolidation loans which impose an even heavier burden on the farmer. Further, programs to assist farmers to improve their commercial credit standing and to induce private lenders to extend credit to farmers will need to be formulated and executed.

One further point needs to be made. Many of the problems cited in our report are attributable to the practices of DOA's farm loan division. A positive sign is that the board of agriculture, which oversees the division, appears to be alert to the problems discussed in our report and can now be expected to exercise closer controls and provide the program with better direction.

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