FASAB Federal Accounting Standards Advisory Board

Credit Program Reconciliation and Technical Amendments To Accounting Standards for Direct Loans and Loan Guarantees In Statements of Federal Financial Accounting Standards No. 2 and No. 18

Exposure Draft

Written comments are requested by August 10, 2000

May 2000

SP-02-19

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (the FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. The Board publishes adopted standards in a Statement of Federal Financial Accounting Standards.

Additional background information is available from the FASAB:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board," amended on October 1, 1999.

- "Mission Statement of the Federal Accounting Standards Advisory Board."

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May 10, 2000

To: Heads of Agencies, Users, Preparers, and Auditors of Federal Financial Information

The Federal Accounting Standards Advisory Board (the Board) is pleased to issue, as an Exposure Draft (ED), Credit Program Reconciliation and Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statements of Federal Financial Accounting Standards No. 2 and No. 18. In this ED, the Board proposes that reporting entities display in a note to their financial statements reconciliations between the beginning and ending balances of the subsidy cost allowance for direct loans and loan guarantee liability on a program-by-program basis for major programs in addition to reconciliation for the entity as a whole. The ED also contains some technical amendments to SFFAS No. 2.

The Board has posed specific questions for comment. You are encouraged to address these questions and to comment on any section of this document. To ensure full understanding of your responses by the Board, please provide your reasons for agreeing or disagreeing with a proposal. You are also encouraged to provide alternative proposals with explanations in areas of disagreement. Written responses are due by August 10, 2000 and should be sent to:

Wendy M. Comes, Executive Director
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In addition, please provide your written comments in electronic form. Written responses in electronic form may be sent by (1) E-mail to mayor.FASAB@gao.gov, or (2) Microsoft Word or WordPerfect file(s) on a diskette mailed to the above address.

The Board may hold a public hearing on this proposed statement. If it decides to hold a hearing, a notice of the date, the place, and the time of the hearing will be published in the Federal Register and in the FASAB Newsletter. Individuals or organizations wishing to make oral presentations at the hearing should notify the Board in writing of that intent at least two weeks before the date of the hearing and provide a copy of their written comments addressing the standards in this exposure draft.

David Mosso
David Mosso
Chairman

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EXECUTIVE SUMMARY

I. In February 2000, the Federal Accounting Standards Advisory Board (the Board) approved Statement of Federal Financial Accounting Standards (SFFAS) No. 18, on accounting for direct loans and loan guarantees, and submitted that statement to the FASAB principals for review.[1] SFFAS No. 18 contains: (a) an amendment to SFFAS No. 2 related to subsidy reestimates, (b) a requirement for reconciliation, and (c) a requirement for disclosure and discussion. This ED proposes an amendment to the reconciliation requirement prescribed in SFFAS No. 18, as well as some technical changes to certain provisions in SFFAS No. 2.

II. The reconciliation standard prescribed in SFFAS No. 18 requires that reporting entities display in a note to their financial statements reconciliations between the beginning and ending balances of (1) the subsidy cost allowance for direct loans and (2) the liability for loan guarantees on an entity-wide basis. In adopting this standard, the Board affirmed the advantages of the entity-wide reconciliation in revealing the overall performance results of direct loan and loan guarantee activities under the entity's management.

III. The reconciliation requirement was initially proposed in an exposure draft issued by the Board in March 1999 (the March 1999 ED). Some respondents to the March 1999 ED commented that program-by-program reconciliation, as opposed to the entity-wide reconciliation, could provide useful information for the evaluation of program performance. The Board found merit in the comment and decided to propose program-by-program reconciliation for major programs in addition to the entity-wide reconciliation. However, since the idea of program-by-program reconciliation was not proposed for public comment in the March 1999 ED, the Board has not received broad input on that option. Thus, the Board publishes this ED to solicit comments on the proposal for the program-by-program reconciliation for major programs.

[1] Pursuant to FASAB Rules of Procedure, as amended in October 1999, the principals' review period for a proposed FASAB statement is 90 days. If no objection is expressed by any of the principals, SFFAS No. 18 will be issued as a final FASAB statement. The accounting standards prescribed in SFFAS No. 18 are presented in Appendix C of this ED.

IV. A primary purpose of requiring reconciliations is to provide information on costs and performance of Federal credit programs. However, credit programs administered by an agency often differ in their characteristics and operating results. Therefore, while an entity-wide reconciliation would provide information on an entity's overall results in administering the credit programs, it would not reveal performance variations among the programs. The Board believes that program-by-program reconciliations would provide information for evaluating program performance.

V. This ED also contains some proposed technical amendments to SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. (The Accounting Standards prescribed in SFFAS No. 2 are presented in Appendix D of this ED.) Some of those amendments are proposed to clarify that the accounting standards are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990. Other amendments proposed in this ED would clarify: (a) the use of discount rates adjusted by interest rate reestimates, and (b) the measurement of default costs of direct loans and loan guarantees.

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QUESTIONS TO RESPONDENTS

The Board solicits views and comments on the questions posed below. Respondents are encouraged to address these questions and to comment on any section of this document. To ensure full understanding of your responses by the Board, please provide your reasons for agreeing or disagreeing with a particular proposal.

(1) The Board proposes that in a note to their financial statements, reporting entities display reconciliations between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees on a program-by-program basis for major programs. Reasons for this proposal are discussed in paragraphs 11 through 14 in Appendix A, Basis for Conclusions. Do you agree with this proposal? Why or why not?

(2) The proposed standard would require that entity management identify major programs on the basis of each entity's specific circumstances. This is based on the view that entity management is in the best position to decide what are major programs for its entity. Do you agree with this approach? Why or why not?

(3) The proposed standard would require that the major programs that are reconciled individually constitute at least 75 percent of the face amount of the outstanding direct or guaranteed loans of the reporting entity. Do you agree with this "at least 75 percent" rule? Why or why not?

(4) Do you believe that the standard should specify certain criteria, such as program size, for identifying major programs? If so, do you believe that the largest programs should be identified as major programs? What other criteria would you suggest?

(5) The Board considered a special situation in which some entities administer credit activities in multiple credit areas. A "credit area" is defined in this ED as an area in which credit is provided to aid a specific type of borrower or industry. There might be several programs in a credit area. The Board proposes that entities in this situation may treat each major credit area as a major program for reconciliation. Do you agree

with the definition for "credit area" and the proposed approach? Why or why not? If not, do you have any alternative suggestions?

(6) SFFAS No. 18 contains provisions that require narrative discussion and disclosure for events and changes in risk factors underlying credit subsidy costs and subsidy reestimates. (See paragraph 11 in Appendix C of this ED.) Do you believe that the proposed requirement for program-by-program reconciliations would complement or detract from the discussion and disclosure requirement? Why?

(7) Do you have any comments on the proposed technical amendments to certain paragraphs and footnotes in SFFAS No. 2? If so, please provide your comments.

INTRODUCTION

PURPOSE AND BACKGROUND

1. The purpose of this Exposure Draft is to solicit comments on the Board's proposal for display in a note to financial statements reconciliations of subsidy cost allowance and loan guarantee liability balances on a program-by-program basis for major programs. Comments are also requested on some technical amendments to accounting standards for direct loans and loan guarantees.

2. In March 1999, the Board issued an Exposure Draft (the March 1999 ED), proposing several requirements related to accounting and financial reporting for direct loans and loan guarantees. Those requirements were: (a) report subsidy reestimates in two components: the interest rate reestimates and the technical/default reestimates, (b) display a reconciliation between beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees on an entity-wide basis, and (c) provide narrative disclosures and discussions to explain the subsidy data. After considering comments on the March 1999 ED, the Board approved the proposals as accounting standards in SFFAS No. 18. In February 2000, the Board submitted SFFAS No. 18 to its principals for review.[2] (See Appendix C, Accounting Standards in SFFAS No. 18.)

3. Several respondents to the March 1999 ED commented that the entity-wide reconciliation would aggregate the program data and, as a result, would not reveal the characteristics and operating results of individual programs. The Board considered the respondents' comments and found merit in their arguments. In

[2] Pursuant to the Board's Rules of Procedure, as amended in October 1999, the principals' review period is 90 days. If no objection is expressed by any of the principals during the review period, SFFAS No. 18 will be issued as a final FASAB statement.

SFFAS No. 18, while affirming the advantages of the entity-wide reconciliation for providing information on the aggregate results of all the credit activities under an entity's management, the Board stated that it would propose program-by-program reconciliation for major programs in addition to the entity-wide reconciliation:

> "The Board was aware that programs administered by an agency often differ in characteristics and subsidy rates. The Board agrees with the view that the entity-wide reconciliation in itself would not reveal variations in program performance. The Board thus decided to issue an exposure draft soon after issuing the statement to propose a display of a program-by-program reconciliation for major programs."[3]

4. In this ED, the Board proposes the program-by-program reconciliation for major programs. The reasons for the Board's conclusion are provided in Appendix A: Basis for Conclusions. Since the entity-wide reconciliation has been adopted in SFFAS No. 18, this ED is not issued to solicit comments on entity-wide reconciliations.

5. Also proposed in this ED are several technical amendments to SFFAS No. 2. (See Appendix D, Accounting Standards in SFFAS No. 2.) Some of those amendments are proposed to clarify that the accounting standards are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990. Other proposed amendments would clarify: (a) the use of discount rates adjusted by the interest rate reestimates, and (b) the measurement of default costs of direct loans and loan guarantees.

EFFECTIVE DATE AND APPLICABILITY

6. The amendments proposed in this ED, if adopted, will be effective for periods beginning after September 30, 2001. Early

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[3]SFFAS No. 18, Amendments to Accounting Standards for Direct Loans and Loan Guarantees, para. 26.

implementation is encouraged. The program-by-program reconciliation requirement does not apply to the consolidated financial statements of the Federal government.

ACCOUNTING STANDARDS
(AMENDMENTS TO SFFAS No. 18 and No. 2)

AMENDMENT TO SFFAS No. 18 - RECONCILIATION

7. Paragraphs 7(A) through 7(E) below supersede paragraph 10 of SFFAS No. 18. (See Appendix C for paragraph 10 of SFFAS No. 18.) The purpose of this amendment is to add a requirement for program-by-program reconciliation for major programs in addition to the entity-wide reconciliation requirement adopted in paragraph 10, SFFAS No. 18. **Comments are solicited only for the program-by-program reconciliation requirement. Since the entity-wide reconciliation requirement has been adopted in SFFAS No. 18, it is not a subject of this Exposure Draft.**

(A) In a note to their financial statements, reporting entities should display for each major program and for the entity as a whole reconciliations between the beginning and ending balances of (a) the subsidy cost allowance for direct loans and (b) the liability for loan guarantees.

(B) Entity management should identify major programs on the basis of each reporting entity's specific circumstances. The major programs that are reconciled individually should constitute at least 75 percent of the face amount of the reporting entity's outstanding direct or guaranteed loans. The reconciliation of other programs should be displayed in aggregate. For year-to-year data comparisons, the designation of major programs should be consistent from one year to another. After the initial designation for the first year in which the reconciliations are reported, reasons for adding or dropping a major program should be explained.

(C) In identifying major programs, entity management should consider the credit areas in which the entity operates. A credit area is an area in which credit is provided to aid a specific type of borrower or industry. There might be a number of programs in a credit area. Entities that administer credit activities in multiple credit areas may consider each major credit area as a major program for reconciliation.

(D) The reconciliation for a major program and for the entity as a whole is accomplished by adding to or subtracting from the beginning balance of the subsidy cost allowance or the loan guarantee liability the dollar amounts of the following items recognized for the current reporting period: (a) subsidy expense, (b) subsidy cost reestimates, (c) fees received, (d) interest supplements paid, (e) direct loans written off or default claims paid, (f) recoveries received, (g) loan modification costs, and (h) other adjustments which include subsidy allowance amortization for direct loans and interest accumulation on the loan guarantee liability.

(E) The requirement to display a reconciliation applies to direct loans and loan guarantees obligated or committed after September 30, 1991, the effective date of the Federal Credit Reform Act of 1990. Reporting entities are encouraged but not required to display reconciliations for direct loans and loan guarantees obligated or committed prior to October 1, 1991, in schedules separate from the direct loans and loan guarantees that were obligated or committed after September 30, 1991.

TECHNICAL AMENDMENTS TO SFFAS No. 2

8. The following technical amendments are made to SFFAS No. 2. (See Appendix D for Accounting Standards in SFFAS No. 2.) The amendments in (A) and (B) below are made to clarify that the accounting standards are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990. Sec. 502 (5)(E) of the Act, as amended, provides that "In estimating net present values, the discount rate shall be the average interest rate on marketable

Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made."

(A) In Paragraph 24, SFFAS No. 2, the phrase "with a similar maturity term" is changed to "with similar maturity to the cash flows."

(B) In footnotes 3, 4, 6, and 7, SFFAS No. 2, the phrase "the remaining maturity" is replaced with the phrase "the remaining cash flows."

9. The following technical amendments to SFFAS No. 2 are necessary as a consequence of making interest rate reestimates. As defined in SFFAS No. 18, paragraph 9(A), "An interest rate reestimate is a reestimate due to a change in interest rates <u>from</u> the interest rates that were assumed in budget preparation and used in calculating the subsidy expense <u>to</u> the interest rates that are prevailing during the time periods in which the direct or guaranteed loans are disbursed." The following amendments are made to clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate reestimate. The adjusted rate should be used for purposes of amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure.

(A) In paragraph 30, SFFAS No. 2, the first sentence is changed to: "The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was used to calculate the present value of the direct loans when the direct loans were disbursed, after adjusting for the interest rate reestimate."

(B) In paragraph 31, SFFAS No. 2, the first sentence is changed to: "Interest is accrued and compounded on the liability for loan guarantees at the interest rate that was used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed, after adjusting for the interest reestimate."

(C) In paragraph 46, SFFAS No. 2, the phrase in the parentheses is changed to "the rate that was originally used to calculate the present value of the direct loans, when the direct loans were disbursed, after adjusting for the interest rate reestimate."

(D) In paragraph 50, SFFAS No. 2, the phrase in the parentheses is changed to "the rate that was originally used to calculate the present value of the liability, when the guaranteed loans were disbursed, after adjusting for the interest rate reestimate."

(E) In paragraphs 57 and 59, SFFAS No. 2, the words "adjusted for the interest rate reestimate" are added immediately after the words "the original discount rate."

10. Paragraph 27 in SFFAS No. 2 is replaced with the following two paragraphs:

(A) The default cost of direct loans results from projected deviations by the borrowers from the payment schedules for principal, interest, and fee payments in the loan contracts. However, the measurement of default cost does not include prepayments and short term delinquencies. The default cost is measured at the present value of projected payment deviations minus projected net recoveries. Projected net recoveries include the amounts that would be collected from borrowers at a later date or the proceeds from the sales of acquired assets minus the costs of foreclosing, managing and selling the assets.

(B) The default cost of loan guarantees results from paying lenders' claims upon default of the guaranteed loans. The default cost of loan guarantees is measured as the present value of projected payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus net recoveries.

APPENDIX A: BASIS FOR CONCLUSIONS

RECONCILIATION

11. In February 2000, the Board approved Statement of Federal Financial Accounting Standards No. 18, which contains the entity-wide reconciliation standard. In that statement, the Board reaffirmed its view that reconciliation between the beginning and ending balances of (1) the subsidy cost allowance for direct loans and (2) the liability for loan guarantees is an effective reporting vehicle for providing information on credit subsidy costs and performance. The Board stated in paragraph 20, SFFAS No. 18:

> As explained in the March 1999 ED, one advantage of displaying the reconciliation is to show in one place the activities that affect the subsidy cost allowance or the loan guarantee liability. In addition to the subsidy expense and reestimates, which are based on projections of future cash flows, the reconciliation schedule also displays data on actual performance, such as fees received, loans written off, claim payments made to lenders, and foreclosed property, loans receivable, or other recoveries acquired during the reporting year. These actual performance data and the data on subsidy cost estimates would be a useful tool to begin assessing the actual performance of a reporting entity's lending or loan guarantee activities against its budget expectations.

12. In discussing entity-wide versus program-by-program reconciliations, the Board expressed its view that both entity-wide and program-by-program reconciliations are useful. It stated that changes in the subsidy cost allowance and the loan guarantee liability reported on an entity's balance sheet indicate the entity's aggregate performance results for all the credit activities under the entity's management. However, the Board agreed with the view that the entity-wide reconciliation in itself does not help reveal performance variations among individual programs. The Board believes that program-by-program reconciliations proposed in this

ED can provide information on individual program's costs and performance.

13. Some programs administered by an entity vary significantly in subsidy costs. To a large extent, the variation might be attributable to differences in program characteristics, such as the purposes of making loans or loan guarantees, the type of borrower, the type of collateral, the loans' maturity term, the level of interest subsidy, and the amount of fees required. For example, subsidy rates and anticipated performance differ significantly among two of the programs administered by Department of Agriculture: the commodity export loan guarantee program and the unsubsidized single family housing loan guarantee program. For the FY 1999 cohorts, the former had an overall subsidy rate of 5.47 percent, and the latter had an overall subsidy rate of 0.09 percent.[4] Those two programs differ in risk characteristics as well. The commodity export loan guarantee program, with an average loan maturity of 3 years, provides guarantees against defaults by foreign banks and importers, whereas the single family housing loan guarantee program, with a loan maturity of 30 years, provides guarantees against defaults by domestic rural home owners.

14. The Board believes program specific information is important for making budgetary decisions and performance evaluations for individual programs. Requiring such information is consistent with the objectives of Federal financial reporting defined in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, Objectives of Federal Financial Reporting. In discussing the evaluation of operating performance as an objective, SFFAC No. 1 states that Federal financial reporting should provide information that helps readers to determine "the costs of providing specific programs and activities and the composition of, and changes in, those costs."[5]

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[4] Federal Credit Supplement, Budget of the United States Government, Fiscal Year 1999, page 5.

[5] SFFAC No. 1, Objectives of Federal Financial Reporting, paragraph 126.

15. In SFFAC No. 2, Entity and Display, the Board reiterated the need for program information: "With some organizations, and even suborganizations, the activities of one or more programs or other components are as important to the readers of the financial statements as are the activities of the entity as a whole. This would be particularly true for a Department composed of many bureaus, administrations, agencies, services, etc., and particularly if their programs are dissimilar."[6]

16. Thus, the Board proposes that in addition to the entity-wide reconciliation, reporting entities display reconciliations on a program-by-program basis. However, in order to avoid excessive detail in data reported by entities with multiple programs, the Board proposes that the display of program-by-program reconciliations be applied to major programs. To assure that adequate program information is provided, the Board believes that the major programs that are reconciled individually should constitute at least 75 percent of the face amount of the entity's outstanding direct or guaranteed loans. The reconciliation of other programs should be displayed in aggregate.

17. To assess how this "major programs" concept might affect various reporting entities, the Board reviewed the number of credit programs administered by various reporting entities. It found three types of situations among the 18 reporting entities that operate credit programs: (a) eleven of the18 entities have three or fewer direct loan or loan guarantee programs, (b) five entities have four to ten direct loan or loan guarantee programs, and (c) two entities, U.S. Department of Agriculture (USDA) and U.S. Department of Housing and Urban Development (HUD), have more than 20 direct loan or loan guarantee programs. (See Appendix B, Number of Programs.)

18. Since the nature and the structure of programs vary among reporting entities, it is not feasible to develop a definition for "major

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[6] SFFAC No. 2, Entity and Display, paragraph 75.

program" that would suit all entities. Thus, the Board stresses that entity management is in the best position to identify major programs based on its entity's specific circumstances. To facilitate year-to year comparisons by the user, the designation of major programs should be consistent from one year to another. After the initial designation for the first year in which the reconciliations are reported, reasons for dropping or adding a major program should be explained.

19. Furthermore, the "major programs" concept is not intended to prohibit entities with very few programs from displaying each program individually. As described in situation (a) above, many entities have no more than three programs. Entities in this situation, particularly those that have only one or two programs, may find it unnecessary or irrelevant to identify major programs. Thus, they may display a reconciliation for each program individually.

20. In proposing the "major programs" concept, the Board has also proposed the "at least 75 percent" rule based on the face amounts of outstanding direct or guaranteed loans. The "at least 75 percent" rule would require that the major programs that are reconciled individually constitute at least 75 percent of the face amount of the reporting entity's outstanding direct or guaranteed loans. The intent in proposing this rule is to assure that adequate program-by-program information is reported to cover a major portion of the reporting entity's credit activities.

21. The Board noted a special situation in which some entities manage credit activities in different credit areas. There may be multiple programs in one credit area. For example, USDA administers some 30 direct loan programs in the areas of farm service, rural community development, rural utilities, rural housing, rural business cooperative service, and foreign agricultural service.[7] Displaying a few major programs among the 30 programs would not provide a

[7] See Federal Credit Supplement, Budget of the United States Government, Fiscal Year 2001, p. 1.

comprehensive and balanced reporting on USDA's direct loan activities. The Board proposes that entities in this situation may consider each major credit area as a major program. This approach would provide a complete presentation of all distinct credit areas. Using this approach, a major program represents an major area of credit activity that is targeted to a particular industry or a particular type of borrower, such as rural utility, or rural housing. However, the two principles contained in the proposed standard still apply to this situation: (a) entity management should identify major credit areas that are to be reconciled as major programs on the basis of the entity's specific circumstances, and (b) the major programs that are reconciled individually should constitute at least 75 percent of the face amount of the entity's outstanding direct or guaranteed loans.

TECHNICAL AMENDMENTS TO SFFAS No. 2

22. Three groups of technical amendments are proposed in this ED. The first group, proposed in paragraph 8 of this ED, would affect paragraph 24 and footnotes 3, 4, 6, and 7 of SFFAS No. 2. The purpose of this group of amendments is to clarify that the accounting standards are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990.[8] Before the amendment, sec 502 (5)(E) of the Act required using as the discount rate in calculating the present value of a direct loan or a loan guarantee, the interest rate of Treasury securities that have a similar maturity to the maturity term of the direct loan or the loan guarantee. After the July 1997 amendment, sec 502 (5)(E) requires using as the discount rate the average interest rate on Treasury securities of similar maturity to the cash flows of a direct loan or loan guarantee.

23. The second group of amendments, proposed in paragraph 9 of this ED, would affect paragraphs 30, 31, 46, 50, 57, and 59 of SFFAS No. 2. These amendments are related to interest rate reestimates.

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[8] OMB has implemented the amendment in Circular A-11, Preparation and Submission of Budget Estimates, July 1999, and in its recent release of a new credit subsidy calculator.

In their budget preparation, credit programs use assumed rates to calculate the subsidy costs of direct loans and loan guarantees. For the fiscal year in which the direct or guaranteed loans are disbursed, entities are required to reestimate the subsidy costs as well as the net present value of direct loans and the liability for loan guarantees, using the interest rates of Treasury securities that are prevailing in the year of disbursement. This reestimate is referred to as "interest rate reestimate." (See paragraph 9(A) in Appendix C of this ED) The proposed amendments would clarify that the effective interest rate of a cohort of direct loans and loan guarantees is the interest rate adjusted by the interest rate reestimate. The adjusted rate should be used for purposes of amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure.

24. It is also proposed in this ED that paragraph 27 of SFFAS No. 2, which describes the measurement of default costs, be replaced with paragraphs 10(A) and 10(B) of this ED. Paragraph 10(A) describes the default costs of direct loans. The description excludes short term delinquencies from measuring the default costs of direct loans. This exclusion would conform to OMB's newly revised credit subsidy calculator. The calculator includes short term delinquencies and prepayments in the measurement of "other subsidy costs" rather than default costs. Paragraph 10(B) describes the default costs of loan guarantees. The costs are measured at the present value of projected payments to lenders, plus the default of fee receipts, minus interest supplements not paid due to the default, and minus net recoveries. Although the primary cause of the default costs for both direct loans and loan guarantees is defaults by the loan borrowers, paragraph 10(B) provides a more precise description of the default costs for loan guarantees.

APPENDIX B: NUMBER OF PROGRAMS ADMINISTERED BY REPORTING ENTITIES

Agency	Direct Loan Programs	Loan guarantee programs
Agency for International Development	0	3
Department of Agriculture	30	12
Department of Commerce (Fisheries Finance)	5	2
Department of Defense	1	2
Department of Education	5	4
Export-Import Bank	1	1
Federal Communications Commission	1	0
GSA	1	0
Department of Health and Human Services	0	3
Department of Housing and Urban Development	0	23
Department of Interior	2	1
Department of State	1	0
Department of Transportation	3	3
Department of Treasury	1	0
Department of Veterans Affairs	4	3
Overseas Private Investment Corp.	1	1
Small Business Administration	2	8
FEMA	2	0

Data Source: Federal Credit Supplement, Budget of the United States Government, Fiscal Year 2001. The table includes programs that will start in FY 2001.

APPENDIX C: THE ACCOUNTING STANDARDS IN SFFAS No. 18

The following standards are prescribed in SFFAS No. 18. The texts of the paragraphs, and paragraph and footnote numbers reproduced in this Appendix are the same as those that appear in SFFAS No. 18. Paragraph 10 is shaded to indicate that it is being amended by this ED.

SUBSIDY REESTIMATES

9. Paragraph 32 in SFFAS No. 2 is amended to read:

Credit programs should reestimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees as required in this standard. There are two kinds of reestimates: (a) interest rate reestimates, and (b) technical/default reestimates [2]. Entities should measure and disclose each program's reestimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the reestimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

(A) An interest rate reestimate is a reestimate due to a change in interest rates <u>from</u> the interest rates that were assumed in budget preparation and used in calculating the subsidy expense <u>to</u> the interest rates that are prevailing during the time periods in which the direct or guaranteed loans are disbursed. Credit programs may need to make an interest rate reestimate for cohorts from which direct or guaranteed loans are disbursed during the reporting year. If the assumed interest rates that were used in calculating the subsidy expense for those cohorts differ from the interest

[2] The term "technical/default reestimate" used in this statement is identical in meaning to the term "technical reestimate" used in OMB Circular A-11, as revised in July 1999.

rates that are prevailing at the time of loan disbursement, an interest rate reestimate for those cohorts should be made as of the date of the financial statements.

(B) A technical/default reestimate is a reestimate due to changes in projected cash flows of outstanding direct loans and loan guarantees after reevaluating the underlying assumptions and other factors that affect cash flow projections as of the financial statement date, except for any effect of the interest rate reestimates explained in (a) above. In making technical/default reestimates, reporting entities should take into consideration all factors that may have affected various components of the projected cash flows, including defaults, delinquencies, recoveries, and prepayments. The technical/default reestimate should be made each year as of the date of the financial statements.

RECONCILIATION

10. The reconciliation requirement:

In a note to the financial statements, reporting entities should display a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability of outstanding loan guarantees reported in the entities' balance sheet. The reconciliation is accomplished by adding to or subtracting from the beginning balance the dollar amounts of the following items: (a) the subsidy expense recognized in the four components as defined in paragraphs 25 through 29 for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy reestimates as defined in paragraph 32, and (c) other adjustments. For direct loans, the other adjustments include loan modifications, fees received, loans written off, foreclosed property or other recoveries acquired, and subsidy allowance amortization. For loan guarantees, the other adjustments include loan guarantee modifications, fees received, interest supplements paid, claim payments made to lenders, foreclosed property or other recoveries acquired, and interest accumulated on the loan guarantee liability. The requirement to display reconciliation applies to direct loans and loan guarantees obligated or committed on or after October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. Reporting entities are encouraged but not required to display reconciliations for direct loans and loan guarantees obligated or committed prior to October 1, 1991, in schedules separate from the credit reform direct loans and loan guarantees.

DISCLOSURE AND DISCUSSION

11. The disclosure and discussion requirements:

(A) Reporting entities should provide a description of the characteristics of the programs that they administer, and should disclose for each program: (a) the total amount of direct or guaranteed loans disbursed for the current reporting year and the preceding reporting year, (b) the subsidy expense by components as defined in paragraphs 25 through 29, recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy reestimates by components as defined in paragraph 32 for those years.

(B) Reporting entities should also disclose, at the program level, the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs, estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts. Each subsidy rate is the dollar amount of the total subsidy or a subsidy component as a percentage of the direct or guaranteed loans obligated in the cohort. Entities may use trend data to display significant fluctuations in subsidy rates. Such trend data, if used, should be accompanied with analysis to explain the underlying causes for the fluctuations.

(C) Reporting entities should disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates. The disclosure and discussion should also include events and changes that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date. Changes in legislation or credit policies include, for example, changes in borrowers' eligibility, the levels of fees or interest rates charged to borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed.

APPENDIX D: THE ACCOUNTING STANDARDS IN SFFAS No. 2

The following standards are prescribed in SFFAS No. 2. The texts of the paragraphs, and paragraph and footnote numbers reproduced in this Appendix are the same as those that appear in SFFAS No. 2. The shaded words, paragraphs, and footnotes are affected by SFFAS No. 18 or are affected by this ED.

Explanation

21. These standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The standards apply to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category.

Accounting Standards

Post-1991 Direct Loans

22. Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

Post-1991 Loan Guarantees

23. For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

24. For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a similar maturity term applicable to the period during which the loans are disbursed (hereinafter referred to as the applicable Treasury interest rate).

25. For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

26. The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.

27. The default cost of direct loans or loan guarantees results from any anticipated deviation, other than prepayments, by the borrowers from the payments schedule in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. Projected net recoveries include the amounts that would be collected from the borrowers at a later date or the proceeds from the sale of acquired assets minus the costs of foreclosing, managing, and selling those assets.

28. The present value of fees and other collections is recognized as a deduction from subsidy costs.

29. Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

Subsidy Amortization and Reestimation

30. The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed. The amortized amount is recognized as an increase or decrease in interest income.

31. Interest is accrued and compounded on the liability of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed. The accrued interest is recognized as interest expense.

32. The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the reestimation should take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates should be recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required.

Criteria for Default Cost Estimates

33. The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent reestimates. Default costs are estimated and reestimated for each

program on the basis of separate cohorts and risk categories. The reestimates take into account the differences in past cash flows between the projected and realized amounts and changes in other factors that can be used to predict the future cash flows of each risk category.

34. In estimating default costs, the following risk factors are considered: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; (6) newly developed events that would affect the loans' performance; and (7) improvements in methods to reestimate defaults.

35. Each credit program should use a systematic methodology, such as an econometric model, to project default costs of each risk category. If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category.

36. Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based. To document actual experience, a data base should be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

Revenues and Expenses

37. Interest accrued on direct loans, including amortized interest, is recognized as interest income. Interest accrued on the liability of loan guarantees is recognized as interest expense. Interest due from Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.

38. Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan

and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

Pre-1992 Direct Loans and Loan Guarantees

39. The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1992, are recognized when it is more likely than not that the direct loans will not be totally collected or that the loan guarantees will require a future cash outflow to pay default claims. The allowance of the uncollectible amounts and the liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors discussed in the previous section should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

40. Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required.

Modification of Direct Loans and Loan Guarantees

41. The term modification means a federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

42. Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Existing contracts may be altered through such means as forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered reestimates, or workouts as defined below, or are permitted under the terms of existing contracts.

43. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection.

44. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms. Workouts are actions taken to maximize repayments of existing direct loans or minimize claims under existing loan guarantees. The expected effects of work-outs on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

A. Modification of Direct Loans

45. With respect to a direct or indirect modification of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the pre-modification value[3] of the loans over their post-modification value[4]. The amount of the modification cost is recognized as a modification expense when the loans are modified.

46. When post-1991 direct loans are modified, their existing book value is changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the original

[3] The term "pre-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[4] The term "post-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

discount rate (the rate that is originally used to calculate the present value of the direct loans, when the direct loans were disbursed).

47. When pre-1992 direct loans are directly modified, they are transferred to a financing account and their book value is changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans. When pre-1992 direct loans are indirectly modified, they are kept in a liquidating account. Their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification.

48. The change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the modification adjustment transfer[5] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

B. Modification of Loan Guarantees

49. With respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification liability[6] of the loan guarantees over their

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[5]OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the decrease in book value, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

[6]The term "post-modification liability" is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).

pre-modification liability[7]. The modification cost is recognized as modification expense when the loan guarantees are modified.

50. The existing book value of the liability of modified post-1991 loan guarantees is changed to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (the rate that is originally used to calculate the present value of the liability when the guaranteed loans were disbursed).

51. When pre-1992 loan guarantees are directly modified, they are transferred to a financing account and the existing book value of the liability of the modified loan guarantees is changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. When pre-1992 direct loan guarantees are indirectly modified, they are kept in a liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification.

52. The change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. The difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the modification adjustment transfer[8] paid or received to offset the gain or

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[7]The term "pre-modification liability" is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

[8]OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the increase in liability, the reporting entity pays to

loss is recognized as a financing source (or a reduction in financing source).

C. Sale of Loans

53. The sale of post-1991 and pre-1992 direct loans is a direct modification. The cost of modification is determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.

54. For a loan sale with recourse, potential losses under the recourse or guarantee obligations are estimated, and the present value of the estimated losses from the recourse is recognized as subsidy expense when the sale is made and as a loan guarantee liability.

55. The book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.[9] For sales of post-1991 direct loans, the modification adjustment transfer[10] paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

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the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

[9]If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.

[10]See footnote No. 7 for an explanation for "modification adjustment transfer".

D. Disclosure

56. Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or lose related to the modification.

Foreclosure of Post-1991 Direct and Guaranteed Loans

57. When property is transferred from borrowers to a federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset at the present value of its estimated future net cash inflows discounted at the original discount rate.

58. If a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the estimated amount of the claim is recognized as a special contra valuation allowance.

59. At a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted at the original discount rate.

60. When assets are acquired in full or partial settlement of post-1991 direct loans or guaranteed loans, the present value of the government's claim against the borrowers is reduced by the amount settled as a result of the foreclosure.

Write-off of Direct Loans

61. When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable.

Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

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