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Report to the Chairman, Committee on the Budget, U.S. Senate

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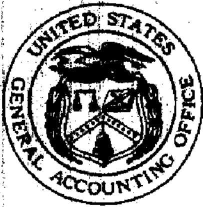
CREDIT REFORM

Appropriation of Negative Subsidy Receipts Raises Questions



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

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September 26, 1994

The Honorable Jim Sasser
Chairman, Committee on the Budget
United States Senate

Dear Mr. Chairman:

You requested that we evaluate several highly technical issues related to implementation of the Federal Credit Reform Act of 1990 (Public Law 101-508). This report, the fifth in a series,[1] responds to your questions regarding agencies' budgetary treatment of negative subsidies (in which receipts exceed outlays) and whether this treatment could cause adverse effects on program management and budgeting.

You specifically asked how the Office of Management and Budget (OMB) has treated negative subsidies of the Federal Housing Administration's (FHA's) Mutual Mortgage Insurance (MMI) Fund and the Export-Import Bank in the budget. We also note the budget treatment of the Government National Mortgage Association's (GNMA) negative subsidy receipts. Further, the report discusses an alternative to appropriating the present value of estimated negative subsidy receipts and the additional legislative requirements imposed on FHA's MMI program.

Results in Brief

The Federal Credit Reform Act does not explicitly address situations in which credit programs may have negative subsidies. Negative subsidies occur when the present value of estimated cash inflows to the government exceeds the present value of cash outflows. In some cases, the Congress has appropriated estimated negative subsidy receipts. FHA's MMI Fund and the GNMA received appropriations of negative subsidy receipts for administrative costs.

Before credit reform, most discretionary credit programs were placed in revolving funds, and revenues were available without appropriation to offset costs. OMB guidance for implementing the Credit Reform Act specifies that negative subsidy receipts are not available for obligation until they have been appropriated and until the direct or guaranteed loans that would create them have been disbursed. Therefore, under this guidance, appropriations of negative subsidy receipts, unlike appropriations of general funds, do not make budget authority

[1]See the list of related GAO products on the last page of this report.

immediately available for obligation. This disconnect between appropriations and available budget authority coupled with the credit reform requirement that budget authority be available before direct loans are obligated or loan guarantees are committed may cause expenditure delays or reductions. Further, this approach also may create an incentive for estimates of negative subsidy receipts to influence estimates of administrative costs, or vice versa.

Programs with both positive and negative subsidy direct loans and loan guarantees, like the Export-Import Bank, present an additional issue. The Credit Reform Act calls for appropriating amounts equal to estimated net subsidy costs (the estimated subsidy cost from positive subsidy direct loans and loan guarantees offset by estimated receipts from negative subsidy loans and loan guarantees). With such an appropriation (or, from another viewpoint, an appropriation equal to estimated net outlays), an agency would not have sufficient budget authority to make all subsidized loans. For the Export-Import Bank, the Congress has provided a general fund appropriation which exceeded the gross subsidy costs of the President's proposed credit program, thereby avoiding difficulties. However, this practice does not conform to the Credit Reform Act's emphasis on net costs.

Appropriating an amount equal to the estimated net subsidy cost along with estimated negative subsidy receipts would conform to the Credit Reform Act and OMB guidance but may not be a solution because, as noted above in our discussion of appropriations for administrative costs of FHA and GNMA, such appropriations do not provide budget authority available for obligation under OMB guidance. This approach would introduce a timing issue because loans or loan guarantees with negative subsidies would have to be disbursed before those with a positive subsidy and at a level that would make enough budget authority available for the agency to obligate planned subsidized loans or loan guarantees.

This potential for difficulties could be avoided by appropriating an amount equal to the gross subsidy cost from general funds with negative subsidy receipts used to reimburse the general fund. For fiscal years 1993 and 1994, the Export-Import Bank received an appropriation of general funds in excess of its proposed gross subsidy cost, thus avoiding the problem of insufficient available budget authority.

FHA's MMI Fund is covered both by the Federal Credit Reform Act and by housing legislation, and the two are not entirely consistent. The housing

legislation directs FHA to establish and maintain the net worth of the Fund, financed by negative subsidy receipts, at a fixed ratio to outstanding debt to cover losses. Thus, post-credit reform borrowers pay for losses from pre-credit reform guarantees and for anticipated losses from their year's group of guarantees. In contrast, under credit reform, permanent indefinite budget authority is provided to cover pre-credit reform losses that exceed liquidating account balances. The current budgetary treatment, whereby FHA holds the required balances in the financing and liquidating accounts, accommodates both laws.

Negative subsidies were treated in the budgets of GNMA, FHA, and the Export-Import Bank in accordance with appropriation, other statutory and/or programmatic requirements, but were not consistent with credit reform requirements. Also, these negative subsidy programs have different characteristics and statutory requirements which have led to each being treated differently from the others.

Background

The Federal Credit Reform Act of 1990 was enacted to better capture the government's cost of extending credit. Through accounting and budget changes, the budget now shows whether credit programs have a cost to the government (a "positive" subsidy to borrowers), break even (zero subsidy cost), or make a "profit" (a negative subsidy cost) before administrative costs are considered. Credit programs have negative subsidies when the estimated cost to the government of providing credit is less than the estimated collections from repayments, interest, and fees, on a present value basis.[2] The cost to the government is affected by the cost of borrowing (at Treasury's rates) and the estimated risk of default. In practical terms, a negative subsidy occurs when the interest rate and/or fees charged to the borrower are more than sufficient to cover the costs of the risk of default.

The Credit Reform Act does not explicitly refer to negative subsidies although its definition of subsidy cost as a net amount implies that it could be negative. Furthermore, we found only one statement in the congressional conference report in which the Congress considered negative subsidies in enacting this law and it referred only to the effect of negative subsidy programs on appropriations subcommittee allocations under the congressional budget process. After enactment of the Credit Reform Act, the Office of Management and Budget (OMB) provided implementation guidance for programs with negative subsidies, and the

[2]Present value means the worth of future returns or costs in terms of money paid today.

Congress appropriated estimated negative subsidy receipts to fund administrative costs of credit programs.

The budgetary treatment of negative subsidy credit programs or activities (whether direct loans or loan guarantees) is outlined in OMB circulars A-11 and A-34 as follows:

1. A special fund receipt and expenditure account, known as a negative subsidy account, is to be established for credit programs and activities with negative subsidies.

2. An amount equal to the negative subsidy is to be obligated in the financing account of the credit activity when a direct loan is obligated or a loan guarantee commitment is made.

3. An amount equal to the negative subsidy is to be paid from the financing account to the negative subsidy account when the loan is disbursed by the government (direct loan) or a third party (guaranteed loan). At that time, a proprietary receipt[3] is recorded in the negative subsidy account which shows negative budget authority in the amount of the estimated negative subsidy. For loans disbursed in several payments, receipts are created as the payments are made and in proportion to the amount of the loan disbursement. Appropriations of receipts may not be obligated until the receipts have actually been credited to the receipt account.

4. These receipts are not available for obligation or expenditure unless appropriated by law.

Budgetary control on credit programs with negative subsidies is imposed by the program limitation (contained in the annual appropriations acts) that sets a maximum face value of credit that may be extended by a program and by the requirement that negative subsidy receipts be appropriated before they are available for obligation. For credit programs with positive subsidies, the level of appropriated budget authority provides budgetary control because programs must have budget authority available before they can obligate a positive subsidy loan. However, a budget authority limit does not control negative subsidy programs because negative subsidy loans do not require budget authority before they can be

[3]A proprietary receipt is a collection from outside the government, deposited in a receipt account, that results from the government's business-type or market-oriented activities. Under credit reform, the present value of the estimated receipt amount would be recorded when the associated loan is disbursed.

obligated; rather, they generate negative budget authority which could be appropriated to expand the program.

A more comprehensive discussion of the history and principles of credit reform is in appendix I.

Scope and Methodology

To attain our objectives, we (1) reviewed criteria such as relevant sections of the Federal Credit Reform Act of 1990, relevant appropriation and authorizing legislation, and OMB guidance, (2) reviewed budget proposals and actions for fiscal years 1992 through 1995 for FHA, GNMA, and the Export-Import Bank and compared them with the appropriate criteria mentioned above, (3) discussed and confirmed the information above with OMB and Congressional Budget Office staff, obtaining their rationales for budget proposals and actions, (4) analyzed the information and supporting rationales, and (5) recommended an alternative approach to the current practice of appropriating present value based estimated negative subsidy receipts that would avoid the potential for delays or reductions in planned expenditures inherent in the current approach.

We performed our work in Washington, D.C., from October 1992 through April 1994 in accordance with generally accepted government auditing standards.

Appropriating Present Valued Estimated Negative Subsidy Receipts Could Cause Delays or Reductions in Planned Expenditures

The Congress has appropriated present valued estimated negative subsidy receipts to fund administrative, but not program, costs of credit transactions. Unlike appropriations of general funds, appropriations of estimated negative subsidy receipts do not provide budget authority immediately available for obligation. Rather, OMB guidance in Circular A-11 provides that an appropriation of budget authority from negative subsidy receipts is available for obligation only when, and if, negative subsidy receipts actually have been credited to the receipt account—done when negative subsidy loans are disbursed—during the budget year. Therefore, in some, if not all, cases these appropriations have been made both before the negative subsidy receipts were transferred to the negative subsidy account and before the action that would create them (that is, the loan disbursement) would have occurred. OMB points out that some ". . . situations may require an appropriation from the general fund sufficient to permit obligations until adequate receipts are available."[4]

[4]OMB Circular A-11, "Preparation and Submission of Budget Estimates," Section 33.5(m), August 1993.

Appropriating present valued estimated negative subsidy receipts to fund administrative costs has the advantage of showing the net cost to the general fund. However, it complicates a program manager's administrative burden. Such appropriations could require an agency to delay some obligations for administrative expenditures to avoid Antideficiency Act violations[5] if the pace of making budget authority available for obligation (from disbursement of negative subsidy loans) is slower than that for planned expenditures. An additional appropriation of general funds might be required to avoid reducing administrative expenditures if the level of available budget authority (by disbursement of negative subsidy loans) is insufficient to cover necessary expenses.[6]

Such delays or reductions could affect credit program operations including credit extension, loan servicing, collection of delinquent loans, and monitoring for compliance with laws and regulations. Further, this approach creates an incentive for estimates of negative subsidy receipts to influence administrative cost estimates, or vice versa. When present value based estimates are used to fund current expenditures, the expenditure will have been made by the time the estimates may be proven incorrect. General funds, from permanent indefinite appropriations, would be required if re-estimates in subsequent years show fewer present value based negative subsidy receipts than expected.

When the Congress has appropriated negative subsidy receipts for the administrative cost of FHA's MMI Program and GNMA's credit program, the appropriated amount has been based on present valued estimated negative subsidy receipts from loans expected to be made in the budget year. For fiscal year 1994, the Congress appropriated negative subsidy receipts for the administrative costs of FHA's MMI Fund ($262.8 million) and of GNMA ($8 million).[7] The statutory language does not indicate whether the Congress was aware that the negative subsidy account might not contain

[5]Section 1341 (a), title 31 U.S.C., the Antideficiency Act, prohibits the making or authorizing of expenditures or obligations which exceed the amount appropriated.

[6]This problem is unlikely to arise with either FHA or GNMA because their operating expenses are paid from the department-level salaries and expenses account of the Department of Housing and Urban Development, and approximately half of the funds in that account are appropriated from the general fund. The account likely contains sufficient funds to support FHA and GNMA operations until negative subsidy loans are disbursed.

[7]For fiscal year 1994, GNMA's fee collections, interest, and other income were expected to exceed expenses by $16 million for post-credit reform loan guarantees. This amount was not to be paid to the negative subsidy account as required by credit reform guidance in OMB's Circular A-11 but was to be retained in the financing account to cover future year expenses and as a reserve against losses that may be incurred on guarantees.

cash receipts in the amount specified at the time of appropriation.[8] However, as explained earlier, the disconnect between appropriations of present valued estimated negative subsidy receipts and the availability of budget authority may cause delays or reductions in planned expenditures.

Credit Reform Requirements Could Cause Unexpected Difficulties for Programs With a Mix of Positive and Negative Subsidy Credit

In accordance with the Credit Reform Act, OMB guidance stipulates that the budget authority needed for a credit program or activity is to be based on the net subsidy cost of the budget year's credit transactions—the gross subsidy cost from positive subsidy loans offset by the "profit" from negative subsidy credit. However, to allow credit obligations and commitments up to authorized program limitations, a program with both positive and negative subsidies must have an appropriation of budget authority equal to the gross subsidy cost. This is because a credit program must have available for obligation a level of budget authority equal to the subsidy cost before obligating a direct loan or making a commitment for a loan guarantee. For programs with both positive and negative subsidies, budget authority based on the net subsidy cost would not be sufficient to make all planned positive subsidy direct loans and loan guarantees.

A hypothetical example involving a credit program comprised of two $100 loans, one with a positive subsidy of 10 percent, the other with a negative subsidy of 5 percent, demonstrates this point. If the program received an appropriation equal to the net subsidy cost ($5), program officials could obligate only the negative subsidy loan because that does not require budget authority. They would not be able to obligate the positive subsidy loan costing $10 because doing so would result in a violation of the Antideficiency Act—obligating $10 rather than the $5 that had been appropriated.

An appropriation equal to the gross subsidy cost may be derived from general funds equal to the gross subsidy cost ($10), or from general funds equal to the net subsidy cost ($5) plus an appropriation of the expected negative subsidy receipts ($5). While the second option may more accurately reflect the expected cost to the government, appropriation of present valued estimated negative subsidy receipts could cause delays or reductions in planned expenditures because, according to OMB guidance, the appropriation does not provide budget authority available for obligation.

[8] The FHA appropriation specifies that approximately $262.8 million is "to be derived from the {negative subsidy} loans receipt account. . ." and the GNMA appropriation specifies that approximately $8 million is "to be derived from the {negative subsidy} loan receipt account. . . ."

For fiscal year 1993, the Congress authorized a higher program limitation ($15.5 billion) than requested in the President's budget and appropriated $757 million from general funds, more than the gross subsidy cost of the requested credit program. This provided sufficient budget authority for the Export-Import Bank to provide more credit than it had planned. Further, because none of the present value based estimated negative subsidy receipts was appropriated, the potential for delays or reductions in planned expenditures was avoided. For fiscal year 1994, the Congress continued to provide an appropriation from general funds but did not specify a program limitation, thus allowing the Bank to make an unlimited amount of negative subsidy loans and loan guarantees. By appropriating general funds that covered the full cost of the Bank's proposed credit program for both years, the estimated costs were reported on a gross basis since estimated receipts were not offset against estimated program costs.

An Alternative Approach to Appropriating Negative Subsidy Receipts

Appropriating general funds for all administrative and subsidy costs of a credit program and using negative subsidy receipts to reimburse the general fund have an advantage over appropriating negative subsidy receipts. General fund appropriations would be available immediately, thus avoiding the delays or reductions in planned expenditures that could arise from the disconnect between appropriation of present value based estimated negative subsidy receipts and the availability of budget authority for obligation. Credit program managers would not need to make program decisions based on whether loans generating negative subsidies already had been made. However, this alternative could misrepresent the net cost of a credit program because negative subsidy receipts would be offset against the appropriations bill as a whole, rather than against the credit program.

Program Legislation May Require Budget Treatment Different From Credit Reform

The housing legislation that established reserve requirements for the FHA's MMI Fund is reconcilable with credit reform requirements. Under the housing legislation, unanticipated losses from credit extended before October 1, 1991, are to be financed through fees paid by later borrowers; however, under credit reform, the taxpayer finances such losses through permanent indefinite budget authority. FHA has effectively resolved these different requirements by using the premiums to raise the balances in the financing and liquidating accounts toward the required reserve level.

Housing legislation enacted concurrently with the Credit Reform Act in another section of the Omnibus Budget Reconciliation Act of 1990 (OBRA

1990) directed the Secretary to establish an MMI Fund reserve at a specified level high enough to ensure the Fund's actuarial soundness.[9] This section of OBRA 1990 also established a premium schedule under which future borrowers will provide funds to increase the Fund balances to achieve and maintain the required reserve level. The Secretary is authorized to adjust premiums and to suspend distributions to past borrowers to ensure that the required reserve level is reached and maintained.

The Credit Reform Act, also contained in OBRA 1990, requires that each year's credit transactions be grouped separately and that a credit subsidy appropriation be obtained to cover their cost. OMB staff report that FHA will draw on the permanent indefinite budget authority under credit reform to cover unanticipated losses from post-credit reform transactions. However, credit reform and the housing legislation differ on the financing source for losses from transactions made prior to October 1, 1991. The Credit Reform Act provides that pre-credit reform borrowers would finance losses to the extent that funds are available in the liquidating account and the taxpayer would cover any excess losses through the permanent indefinite budget authority. The housing legislation provides that fees from current and pre-credit reform borrowers held as part of the required reserve would cover losses on pre-credit reform transactions.

OMB and FHA have dealt with the differing requirements of the two laws by building balances in the financing and liquidating accounts toward the required reserve level. In fiscal year 1992, FHA transferred $505 million in negative subsidy receipts from the financing account to the liquidating account. This transfer, along with the subsidy receipts retained in the financing account for estimated defaults on loans to be made in fiscal year 1992, began building the MMI Fund to the required reserve level. In fiscal year 1993, $1.4 billion of negative subsidy receipts was added to the liquidating account's balance. The President's fiscal year 1995 budget estimates that $1.1 billion in negative subsidy receipts will be paid to the liquidating account in fiscal year 1994 and $1.4 billion in fiscal year 1995 to build the fund balance toward the reserve level required to be achieved by November 2000.

When possible, two provisions of law dealing with the same matter should be reconciled to the greatest extent practical to give maximum effect to both since it is presumed that a consistent body of law was intended. This

[9] OBRA 1990, 12 U.S.C. 1711 (f)(1), requires that FHA achieve and maintain the economic net worth of the Fund, defined as the current cash available to the Fund plus the net present value of future cash flows, at or greater than 2 percent of the remaining obligation on outstanding mortgages by November 2000.

principle is especially relevant when the Congress enacts both provisions at the same time in the same legislative vehicle—in this case in the Omnibus Budget Reconciliation Act of 1990. In our view, the capital reserve requirements and the requirements of credit reform are reconcilable. When drafting the Credit Reform Act, the Congress did not exempt the MMI fund from credit reform requirements. At the same time, the Congress recognized that under credit reform, excesses in some accounts would be transferred to the General Fund of the Treasury. However, the conference report accompanying the final version of the Credit Reform Act also stated that these excesses would not include "balances necessary to maintain adequate reserves, achieve mandated capital levels, or preserve the mutuality of certain credit programs."[10] Moreover, the Congress, in the same statute, required FHA to maintain a certain reserve level. In our opinion, FHA's approach of dividing the reserve between the credit reform financing and liquidating accounts is a reasonable approach to reconciling the differing statutory requirements.

While this treatment is reasonable, the FHA credit accounts differ in certain respects from other credit accounts. First, estimated negative subsidy receipts were paid from the financing account to the liquidating account instead of to a negative subsidy account as specified by credit reform requirements. Second, FHA transferred a present value amount, to be based on estimates, from the financing account to the liquidating account which the Credit Reform Act defines as cash based. Third, the practice of shifting funds received from current loans to cover default costs of pre-credit reform loans breaches the strict wall in the Credit Reform Act that separates credit transactions made before October 1, 1991, from those made later. On the other hand, the Congress established the MMI Fund reserve so that premiums paid by current FHA borrowers would finance losses of pre-credit reform MMI loan guarantees.

Conclusions

Appropriating present valued estimated negative subsidy receipts, as done currently to fund administrative costs in FHA's MMI Program and GNMA, may cause delays or reductions in planned expenditures. This could happen if budget authority made available for obligation, according to OMB guidance, by disbursement of negative subsidy loans does not keep pace with planned expenditures. An additional appropriation of general funds may be needed to avoid program reductions when the level of negative subsidy loan disbursement is insufficient to make available for obligation the amount of budget authority needed for administrative expenditures. Such

[10] H. Rept. 101-964.

an approach also may create incentives for estimates of negative subsidy receipts to influence estimates of expenditures, or vice versa.

The current congressional practice of providing to the Export-Import Bank a general fund appropriation which exceeds the gross subsidy cost of its proposed credit program avoids the difficulties posed by the credit reform requirement for an appropriation to equal cost (defined as a net amount). While this appropriation level also could have been provided from a combination of general funds and negative subsidy receipts, appropriating estimated negative subsidy receipts could cause delays or reductions in planned expenditures. Regardless of the source of the funding, however, the appropriation must at least equal the gross subsidy cost for the Export-Import Bank to be able to complete all planned positive subsidy transactions, subject to the program limitation.

FHA's MMI Fund currently is subject to two different statutory regimes—the Credit Reform Act of 1990 and the OBRA 1990 housing provisions. Credit reform provides a permanent appropriation to cover losses from credit transactions made prior to October 1, 1991, when liquidating account balances are insufficient, while housing provisions require that the Fund's reserve be used. Although either approach alone could be used to finance losses, OMB and FHA have implemented these statutes in a way that reasonably accommodates both.

Recommendations to the Congress

To avoid the potential for appropriations of estimated negative subsidy receipts to cause delays or reductions in planned expenditures which may occur under OMB's reasonable implementing guidance, we recommend that the Congress appropriate only general funds for all subsidy and administrative costs of credit programs, using negative subsidy receipts to reimburse the general fund.

We recommend that the Congress amend the Credit Reform Act to require the appropriation of an amount equal to the gross subsidy cost for credit programs with both positive and negative subsidy components.

Agency Comments and Our Evaluation

OMB provided comments on a draft of this report. In addition, some technical comments were transmitted informally and have been incorporated where appropriate.

OMB agreed with our recommendation to appropriate general funds for the subsidy costs of credit programs as an appropriate budgetary treatment for credit programs with a mixture of positive and negative subsidies. We did not limit this treatment only to programs with a mixture of positive and negative subsidies or only to the subsidy cost. It could be used for all credit programs with negative subsidy receipts, including those with entirely negative subsidy costs, and would apply to administrative costs as well as subsidy costs. OMB said that because delays in obligations are currently not a problem for the two programs (FHA's MMI and GNMA) operating with entirely negative subsidies, the delay problem currently exists only for programs with a mixture of positive and negative subsidies. We would not apply this treatment to FHA's MMI program because of the additional requirements in the housing authorization sections of OBRA 1990.

OMB also said that "although it was not strictly consistent with a narrowly interpreted definition of cost in the FCRA [Federal Credit Reform Act], appropriations were requested, enacted, and executed for EXIM Bank on a gross basis, while offsetting the appropriations action with the negative subsidy receipts. This method was developed to resolve the types of problems that GAO lists in this report."

Although the amount requested may have been equal to the gross subsidy cost and OMB may have treated the appropriation as if it were a gross amount during budget execution, the appropriation language in both the OMB request and the enacted appropriation specified that the appropriation was for the "cost" of the credit program as "defined in section 502 of the Congressional Budget Act of 1974." This section says ". . . the term 'cost' means the estimated long-term cost to the Government of a direct loan or loan guarantee, calculated on a net present value basis. . . ." We recommended that the Congress consider changing the Credit Reform Act to address this problem which is discussed earlier in our report and acknowledged by OMB.

OMB concurred with our conclusion that OMB and FHA have implemented different statutory provisions from the Credit Reform Act and the housing sections of the OBRA 1990 in a way that reasonably accommodates both laws.

We will send copies of this report to the Acting Director of the Office of Management and Budget, the Director of the Congressional Budget Office, the Secretary of Treasury, the Secretary of Housing and Urban

Development, the President of the Government National Mortgage Association, the President and Chairmen of the EXIM Bank, the Chairman and the ranking minority members of the Senate Committee on Appropriations and the House Committee on Appropriations. We also will make copies available to others upon request.

Please contact me at (202) 512-9142 if you or your staff have any questions. Major contributors to this report are listed in appendix II.

Sincerely yours,

Susan J. Irving
Associate Director
Budget Issues

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Abbreviations

AFMD	Accounting and Financial Management Division
AIMD	Accounting and Information Management Division
FCRA	Federal Credit Reform Act
FHA	Federal Housing Administration
GAO	General Accounting Office
GI/SRI	General Insurance and Special Risk Insurance Program
GNMA	Government National Mortgage Association
MMI	Mutual Mortgage Insurance
OBRA	Omnibus Budget Reconciliation Act
OMB	Office of Management and Budget

Background: Credit Reform

This background appendix also will be a part of two other reports on credit reform implementation: the use of estimated future credit savings to offset current spending[1] and an evaluation of decisions to include certain programs under the Federal Credit Reform Act.[2]

The federal government uses direct loans and loan guarantees as tools to achieve numerous program objectives such as assistance to housing, agriculture, education, small businesses, and foreign governments. At the end of fiscal year 1993, the face value of the government's direct loans and loan guarantees totaled a reported $861 billion, of which $201 billion was in direct loans and $660 billion was in loan guarantees.

After over 20 years of discussion about the shortcomings of using cash budgeting for credit programs and activities, the Federal Credit Reform Act of 1990 was enacted on November 5, 1990, as Title 13B of the Omnibus Budget Reconciliation Act of 1990, Public Law 101-508. The Credit Reform Act changed the budget treatment of credit programs so that their costs can be compared more accurately with each other and with the costs of other federal spending. It also was intended to ensure that the full cost of credit programs over their entire lives would be reflected in the budget when the loans were made so that the executive branch and the Congress might consider that cost when making budget decisions.

In addition, it was recognized that credit programs had different economic effects than most budget outlays, such as purchases of goods and services, income transfers, and grants. In the case of direct loans, for example, the fact that the loan recipient was obligated to repay the government over time meant that the economic impact of a direct loan disbursement could be much less than other budget transactions of the same dollar amount.

Credit Reform Was Designed to Remove Difficulties Caused by Cash Treatment

Before credit reform, it was difficult to make appropriate cost comparisons between direct loan and loan guarantee programs and between credit and noncredit programs. Credit reform requirements were formulated to address the factors that caused this problem.

[1]See Credit Reform: Speculative Savings Used to Offset Current Spending Increase Budget Uncertainty (GAO/AIMD-94-46, March 18, 1994).

[2]See Credit Reform: Case-by-Case Assessment Advisable in Evaluating Coverage, Compliance (GAO/AIMD-94-57, July 28, 1994).

Two key principles of credit reform are (1) the definition of cost in terms of the present value of cash flows over the life of a credit instrument and (2) the inclusion in the budget of the costs of credit programs in the year in which the budget authority is enacted and the direct or guaranteed loans are disbursed.

Credit Reform Was Designed to Allow Appropriate Cost Comparisons

Before credit reform, credit programs—like other programs—were reported in the budget on a cash basis. This cash basis distorted costs and, thus, the comparison of credit program costs with other programs intended to achieve similar purposes, such as grants. It also created a bias in favor of loan guarantees over direct loans.

Loan guarantees appeared to be free in the short run while direct loans appeared to be very expensive because the budget did not recognize that at least some of the loan guarantees would default and that some of the direct loans were to be repaid.

For direct loans, the budget for most discretionary accounts used revolving funds which showed budget authority and outlays in the amount that loan disbursements in the current year exceeded repayments received from all past loans in that budget year. This cash approach overstated direct loan costs in the initial years of a program when loan disbursements were likely to be greater than repayments. Conversely, this treatment understated costs in later years when loan repayments were more likely to be much larger relative to disbursements. Cash-based budgeting did not recognize that at least a portion of the loan outlays would be repaid in the future. In contrast, for loan guarantees, the budget did not record any outlays when the guarantees were made (except the negative outlay resulting from any origination fees), even though they were likely to entail future losses. Budget authority and outlays were recorded only when, and if, defaults occurred.

Credit reform changed this treatment for direct loans and loan guarantees made on or after October 1, 1991. It required that budget authority to cover the cost to the government of new loans and loan guarantees (or modifications to existing credit instruments) be provided before the loans, guarantees, or modifications are made. Credit reform requirements specified a net cost approach using estimates for future loan repayments and defaults as elements of the cost to be recorded in the budget. This puts direct loans and loan guarantees on an equal footing; it permits the

costs of credit programs to be compared with each other and with the costs of noncredit programs when making budget decisions.

Credit Reform Identifies the Government's Cost of Credit Activities

Credit reform requirements separate the government's cost of extending or guaranteeing credit, called the subsidy cost, from administrative and unsubsidized program costs. Administrative expenses receive separate appropriations. They are treated on a cash basis and reported separately in the budget. The unsubsidized portion of a direct loan is that which is expected to be recovered from the borrower.

The Credit Reform Act defines the subsidy cost of direct loans as the present value of disbursements—over the loan's life—by the government (loan disbursements and other payments) minus estimated payments to the government (repayments of principal, payments of interest, and other payments) after adjusting for projected defaults, prepayments, fees, penalties, and other recoveries. It defines the subsidy cost of loan guarantees as the present value of cash flows from estimated payments by the government (for defaults and delinquencies, interest rate subsidies, and other payments) minus estimated payments to the government (for loan origination and other fees, penalties, and recoveries). In making these calculations, agencies must include the cost to the federal government of borrowing the funds.

According to OMB guidance, credit programs have a positive subsidy, that is, they lose money, when the present value of estimated payments by the government exceeds the present value of estimated receipts. Conversely, negative subsidy programs are those in which the present value of estimated collections is expected to exceed the present value of estimated payments; in other words, the programs make money (aside from administrative expenses).

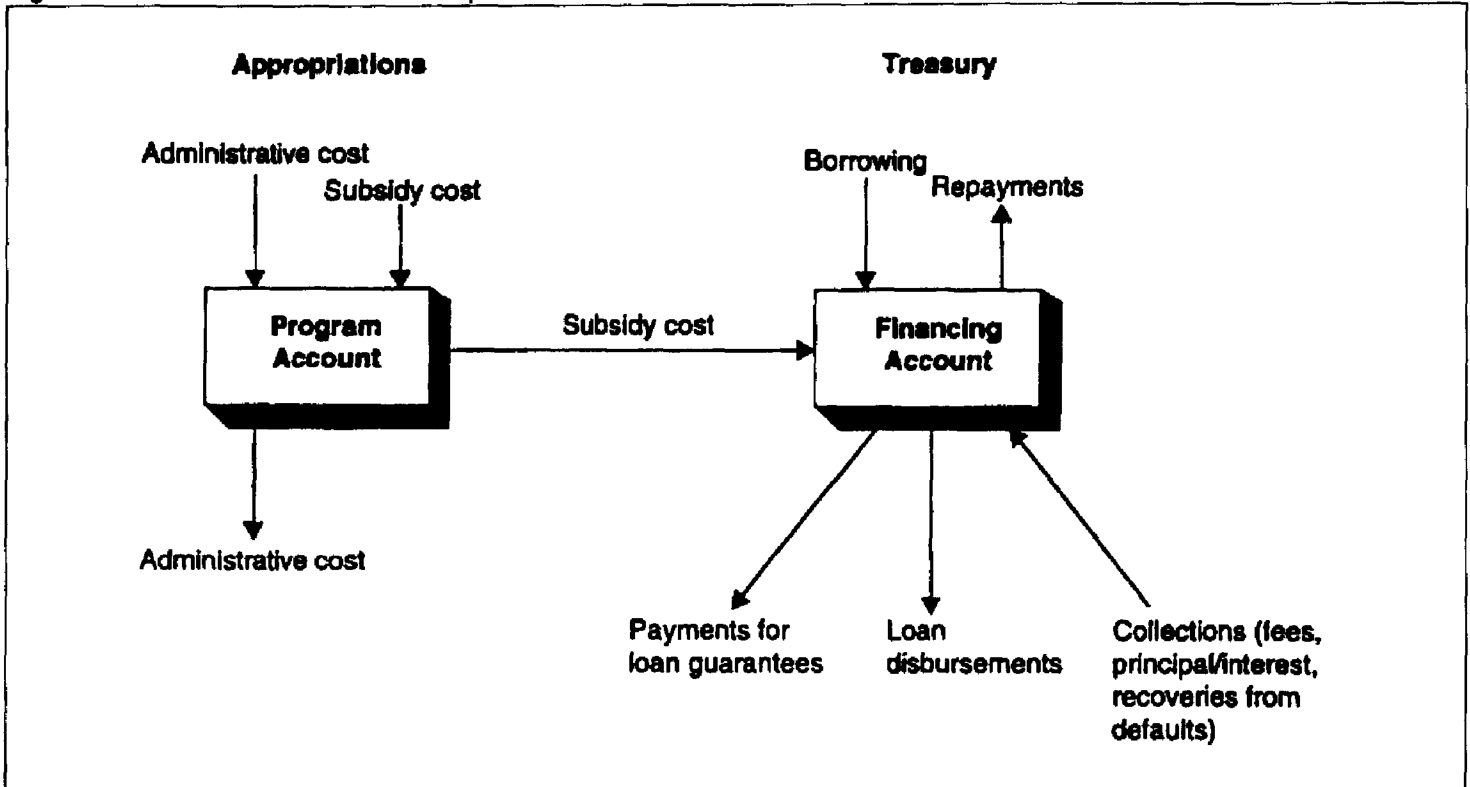
Credit Programs Now Use Three Budgetary Accounts

The Credit Reform Act set up a special budget accounting system to record the budget information necessary to implement credit reform. It provides for three types of accounts—program, financing, and liquidating—to handle credit transactions.

Credit obligations and commitments made on or after October 1, 1991—the effective date of credit reform—use only the program and financing accounts. The program account receives separate appropriations for administrative and subsidy costs of a credit activity and is included in

budget totals. When a direct or guaranteed loan is disbursed, the program account pays the associated subsidy cost for that loan to the financing account. The financing account, which is nonbudgetary,[3] is used to record the cash flow associated with direct loans or loan guarantees over their lives. It finances loan disbursements and the payments for loan guarantee defaults with (1) the subsidy cost payment from the program account, (2) borrowing from the Treasury, and (3) collections received by the government. Figure I.1 diagrams this cash flow.

Figure I.1: Credit Reform Cash Flow Simplified



If subsidy cost calculations are accurate, the financing account will break even over time as it uses its collections to repay its Treasury borrowing.

[3]Nonbudgetary accounts may appear in the budget document for information purposes but are not included in the budget totals for budget authority or budget outlays. They do not belong in the budget because they show only how something is financed, and do not represent the use of resources.

Direct loans and loan guarantees made before October 1, 1991, are reported on a cash basis in the liquidating account. This account continues the cash budgetary treatment used before credit reform. It has permanent indefinite budget authority[4] to cover any losses. Excess balances are transferred periodically—at least annually—to the Treasury.

In addition to the three accounts specified in the Credit Reform Act, OMB has directed that credit programs or activities with negative subsidies must have special fund receipt accounts to hold receipts generated when the program or activity shows a profit. OMB guidance provides that these funds cannot be used unless appropriated.

OMB and Treasury Provide Implementation Guidance

OMB and the Department of the Treasury provide guidance on implementing credit reform. OMB's written guidance is contained primarily in OMB Circulars A-11, A-34, and A-129.[5] OMB also has issued memoranda to provide additional implementation guidance addressing specific situations. The Treasury's guidance is provided in materials such as Basic Transactions Relating to Guaranteed Loans and Subsidies (April 30, 1992) which contains a number of illustrative cases developed by its Financial Management Service and distributed to agencies as examples of how to account for credit reform transactions.

Individual Program Characteristics Raise Credit Implementation Questions

Fiscal year 1994 is the third year that credit programs have been required to comply with credit reform. Both agencies that operate credit programs and those that provide implementation guidance—OMB and Treasury—have had to address a variety of situations for which the Credit Reform Act does not provide explicit direction. Questions have arisen and continue to arise as the agencies implement credit reform. Several groups have been created, such as the Federal Credit Policy Working Group and the Credit Reform Steering Committee, to address these implementation issues and questions.

[4]Permanent budgetary authority is available as a result of permanent legislation and does not require annual appropriation. Indefinite budget authority is budget authority of an unspecified amount of money.

[5]OMB Circular A-11 is titled "Preparation and Submission of Budget Estimates"; Circular A-34 is titled "Instructions on Budget Execution"; Circular A-129 is titled "Managing Federal Credit Programs."

Major Contributors to This Report

Accounting and Information Management Division, Washington, D.C.

Christine Bonham, Assistant Director
Carolyn Litsinger, Evaluator-in-Charge

Office of the General Counsel

Charles Roney, Assistant General Counsel
Bertram Berlin, Assistant General Counsel
Carlos Diz, Attorney-Advisor

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Credit Reform: Case-by-Case Assessment Advisable in Evaluating Coverage, Compliance (GAO/AIMD-94-57, July 28, 1994).

Credit Reform: Speculative Savings Used to Offset Current Spending Increase Budget Uncertainty (GAO/AIMD-94-46, March 18, 1994).

Federal Credit Reform: Information on Credit Modifications and Financing Accounts (GAO/AIMD-93-26, September 30, 1993).

Federal Credit Programs: Agencies Had Serious Problems Meeting Credit Reform Accounting Requirements (GAO/AFMD-93-17, January 6, 1993).

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