

VOLUME 12, CHAPTER 4: “DIRECT LOANS AND LOAN GUARANTEES”

SUMMARY OF MAJOR CHANGES

All changes are denoted by **blue font**.

Substantive revisions are denoted by an * symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by **bold, italic, blue and underlined font**.

The previous version dated September 2008 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
Table of Contents	Add Table of Contents as this was omitted in last update	Add
Appendix A	Deleted and reader directed to Treasury web site for most recent U.S. Standard General Ledger accounts and definitions	Delete

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CHAPTER 4

DIRECT LOANS AND LOAN GUARANTEES

0401 OVERVIEW

040101. Purpose

This chapter establishes the Department of Defense (DoD) policy and procedures for direct loans and loan guarantees for non-Federal borrowers. The policies and procedures for credit programs reflect the requirements of the [*Federal Credit Reform Act of 1990*](#), as amended. The major purposes of the Act are to: (a) measure more accurately the costs of Federal credit programs; (b) place the cost of credit programs on a budgetary basis equivalent to other Federal spending; (c) encourage the delivery of benefits in the form most appropriate to the needs of beneficiaries; and (d) improve the allocation of resources among credit programs and between credit and other spending programs.

040102. General

The policies set forth in this chapter apply to direct loan obligations and loan guarantee commitments. It implements the [*Accounting for Direct Loans and Guarantees*](#), Statement of Federal Financial Accounting Standards (SFFAS) No. 2, [*Amendments to Accounting Standards for Direct Loans and Loan Guarantees*](#), SFFAS No. 18, and [*Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS No. 2*](#), SFFAS No. 19.

* 040103. References

Reporting requirements, instructions, implementation guidance, and instructions for calculating subsidy estimates and reestimates, as well as background information are contained in the Office of Management and Budget (OMB) [*OMB Circular A-11, Part 5, "Federal Credit."*](#)

A. Treasury Department reporting instructions, "Treasury Reporting Instructions for Credit Reform Legislation," are provided in Volume 1, Part 2, of the Treasury Financial Manual <http://www.fms.treas.gov/tfm/vol1/v1p2c460.html>.

B. Policies and procedures prescribed by OMB for justifying, designing, and managing Federal credit programs are contained in [*OMB Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivables."*](#)

0402 STANDARDS

040201. Explanation

The specific accounting standards for direct and guaranteed loans are discussed in this chapter. The standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees.

040202. Accounting Standards

A. Post-1991 Direct Loans. Refers to direct loan obligations made on or after October 1, 1991, and the resulting direct loans. 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.

B. Post-1991 Guarantees. Refers to loan guarantee commitments made on or after October 1, 1991, and the resulting loan guarantees. 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.

C. Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees. A subsidy expense is recognized for direct or guaranteed loans disbursed during a fiscal year. The amount of 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 average interest rate on marketable U.S. Treasury securities of similar maturity to the cash flows of the loan or loan guarantee for which the estimate is being made.

1. 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 as interest subsidy costs, default costs, fees and other collections, and other subsidy costs.

2. 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 U.S. Treasury interest rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.

3. 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 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.

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

5. 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.

D. Subsidy Amortization and Reestimation. 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 loans were disbursed**. The amortized amount is recognized as an increase (when effective interest exceeds nominal interest) or decrease (when nominal interest exceeds effective interest) in interest income. Nominal interest equals the nominal balance (i.e., the face amount) of the loan outstanding at the beginning of the period multiplied by **the interest rate stated in the loan contract**. Effective interest equals the book value of the loan (i.e., net of allowance for subsidy) multiplied by the applicable U.S. Treasury interest rate.

1. Interest is accrued and compounded on the liability of 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. The accrued interest is recognized as interest expense.

2. 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 takes into account all factors that may have affected the estimate of each component of the cash flow, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates is recognized as an increase in subsidy expense (or a reduction in subsidy expense). Components are not required to report the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates.

E. Criteria for Default Cost Estimates. The criteria for default cost estimates 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 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.

1. In estimating default costs, the following risk factors are considered: (a) loan performance experience; (b) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (c) financial and other relevant characteristics of borrowers; (d) the value of collateral to loan balance; (e) changes in recoverable value of collateral; and (f) newly developed events that would affect the performance of the loan. Improvements in methods to reestimate defaults also are considered.

2. Each credit program shall use a systematic methodology, such as an econometric model, to project default costs of each risk category. If individual accounts contain significant dollars that would then carry a proportionately higher weight in terms of risk exposure, then an analysis of the individual accounts is warranted in making the default cost estimate for that category.

3. The actual historical experience for the performance of a risk category is a primary factor upon which an estimation of default cost is based. To document actual experience, a database shall be maintained to provide historical information on actual payments, prepayments, late payments, defaults, recoveries, and amounts written off.

F. Revenues and Expenses. 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 the U.S. Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to the U.S. Treasury is recognized as interest expense. 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.

G. Pre-1992 Direct Loans and Loan Guarantees. The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1991, are recognized, when it is more likely than not that the direct loans will not be collected totally, or that the loan guarantees will require a future cash outflow to pay default claims.

1. The allowance for uncollectible amounts and the liability of loan guarantees shall be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors discussed in subparagraph 040202.E.1. must be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

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

H. Modification of Direct Loans and Loan Guarantees. The term "modification" means a Federal action, including new legislation or administrative action, which directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.

1. 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 in subparagraph 040202.H.3., or are permitted under the terms of existing contracts.

2. 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.

3. The term "modification" does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, or 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 workouts on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

I. Modification of Direct Loans. 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 premodification value of the loans over the post-modification value of those loans. The amount of the modification cost is recognized as a modification expense when the loans are modified.

1. When a post-1991 direct loan is modified, the existing book value of that loan is changed to an amount equal to the present value of the net cash inflows projected under the modified terms from the time of modification to the loan's maturity. That amount is discounted at the original discount rate. (The rate that originally was used to calculate the present value of the direct loan, when the direct loan was disbursed, [after adjusting for the interest rate reestimate.](#))

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

3. The changes in the book value of both pre-1992 and post-1991 direct loans, resulting from a direct or indirect modification, and the cost of modification, normally will differ due to the use of different discount rates or 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 paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

J. Modification of Loan Guarantees. 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 of the loan guarantees over the premodification liability of those loan guarantees. The modification cost is recognized as modification expense when the loan guarantees are modified.

1. 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 maturity of those loans, discounted at the original discount rate (the rate that originally is used to calculate the present value of the liability when the guaranteed loans were disbursed, after adjusting for the interest rate [reestimate](#).)

2. When a pre-1992 loan guarantee is directly modified, the modified loan guarantee is 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 its post-modification liability. Any subsequent modification is treated as a modification of a post-1991 loan guarantee. When a pre-1992 loan guarantee is indirectly modified, that loan guarantee is kept in a liquidating account. The liability of such a loan guarantee is reassessed and adjusted to reflect any change in the liability resulting from the modification.

3. 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 normally will differ, due to the use of different discount rates or the use of different measurement methods. Any 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 paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

K. Disclosure. 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 loss related to the modification. For further information on financial statement disclosures regarding direct or guaranteed loans, go to “Notes to the Financial Statements,” Volume 6B, Chapter 10, Note 8.

L. Foreclosure of Post-1991 Direct Loans and Guaranteed Loans. 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 compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset. The asset is recorded at the present value of its estimated future net cash inflows discounted at the original discount rate, [adjusted for the interest rate reestimate](#).

1. 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 present value of the estimated claim is recognized as a special contra valuation allowance.

2. Upon the foreclosure of a guaranteed loan, a Federal guarantor may acquire the loan involved. The acquired loan is recognized at the present value of its estimated net cash inflows from selling the loan or from collecting payments from the borrower, discounted at the original discount rate, [adjusted for the interest rate reestimate](#).

3. 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.

M. Write-off of Direct Loans. When post-1991 direct loans are written off, the unpaid principal of each such loan 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 reflected in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses. The most current policy issued is OMB Circular A-129.

N. Additional Disclosures Required for Periods Beginning After September 30, 2000. The SFAS No. 18, "Amendments to Accounting Standards for Direct Loans and Loan Guarantees," require additional disclosures. Beginning in FY 2001, Federal agencies are required to:

1. Report subsidy reestimates in two distinct components: the interest rate reestimate and the technical/default reestimate

2. Display reconciliation between the beginning and the ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, reported in an entity's balance sheet

3. Provide a description of program characteristics and disclose:

a. the amounts of direct or guaranteed loans disbursed in each program during the reporting year;

b. the estimated subsidy rates for the total subsidy and the subsidy components at the program level in the current year's budget for the current year's cohorts;

c. 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; and

d. past events and changes in conditions that may be likely to have a significant impact, but the effects of which are not measurable at the reporting date.

0403 CREDIT REFORM FUND CONTROLS

040301. Fund Control

For credit programs, systems for administrative control of funds are required to include the following features:

A. Restrict both obligations and expenditures from each program account, financing account, and liquidating account to the lesser of:

1. The amounts available for administrative expenses, direct loan

subsidies, direct loan levels, guaranteed loan levels, and any limitations specified in law; or

2. The amounts apportioned for the amounts specified.

B. Enable the fixing of responsibility for an obligation or expenditure exceeding the categories specified.

C. Simultaneously determine, at the obligation stage for direct loans and at the commitment stage for guaranteed loans, whether sufficient budget authority for the subsidy exists in the program account and whether a sufficient unused loan level limit exists in the financing account. The system for calculating obligations also must be capable of changing the subsidy calculation when the U.S. Treasury changes interest rates. (Rate changes do not affect obligated but undisbursed loans in the case of direct loans and committed but undisbursed loans in the case of guaranteed loans.)

040302. Anti-deficiency Act Violations

Anti-deficiency Act violations for direct loans, guaranteed loans, and financing accounts are reportable to the President, through the Director of the OMB, and to the Congress. For additional information, go to “Anti-Deficiency Act Violations,” Volume 14, Chapter 2. Violations include:

A. Overobligation or Overexpenditure of the Subsidy. This is any case where an officer or employee of the U.S. Government makes or authorizes an expenditure or creates or authorizes an obligation, including a commitment, that is in excess of amounts appropriated and apportioned for (1) the direct loan subsidy or (2) the guaranteed loan subsidy. Examples of violations include modifications of direct loans or loan guarantees, such as forgiveness, forbearance, reductions in interest rate, prepayments without penalty, and extensions of maturity, that result in obligations in excess of apportioned unobligated balances or subsidy amounts.

B. Overobligation or Overexpenditure of the Credit Level Supportable by the Enacted Subsidy

This is any case where an officer or employee of the U.S. Government makes or authorizes an expenditure or creates or authorizes an obligation, including a commitment, that is in excess of the credit program level supportable by the enacted subsidy, regardless of whether the subsidy is positive or negative. This includes obligations or expenditures that are in excess of: (1) the direct loan level, (2) the guaranteed loan level, or (3) any limitations on the loan level or the Federal share of guaranteed loan levels.

C. Overobligation or Overexpenditure of the Amount Appropriated for Administrative Expenses

This is any case where an officer or employee of the U.S. Government makes or authorizes an expenditure or creates or authorizes an obligation, including a commitment, which is in excess

of the amount appropriated for administrative expenses.

D. Obligation or Expenditure of the Expired Unobligated Balance of the Subsidy Except to Correct Mathematical or Data Input Errors in Calculating Subsidy Amounts

This is any case where an officer or employee of the U.S. Government makes or authorizes an expenditure or creates or authorizes an obligation, including a commitment, against unobligated subsidy balances after the period of obligation authority has expired. Correction of mathematical or data input errors up to the amount of the lapsed unobligated balance of the subsidy are specifically exempted. Corrections of these errors in excess of the amount of the expired unobligated balance of the subsidy are violations.

0404 CREDIT APPORTIONMENT AND REAPPORTIONMENT

Unless specifically exempted by OMB, all program, financing, and liquidating accounts shall be apportioned. This subject is discussed in full detail in Volume 3, Chapter 2, "Apportionment and Reapportionment."

0405 REPORT ON BUDGET EXECUTION AND BUDGETARY RESOURCES ([Standard Form 133](#))

040501. Coverage

Unless otherwise specified by the OMB, the Report on Budget Execution and Budgetary Resources shall be prepared to provide current data on each credit account, whether apportioned or not. Current reporting requirements are published in [OMB Circular A-11, Part 4, "Instructions on Budget Execution."](#)

040502. Timing of Reports

The Report on Budget Execution and Budgetary Resources shall be submitted electronically through the Department of the Treasury Federal Agencies' Centralized Trial-Balance System (FACTS II), each quarter or such other time period specified by the OMB. The dates for reporting budget execution data through FACTS II can be obtained at: <http://www.fms.treas.gov/factsii/index.html>. A copy of the SF 133 for each calendar quarter shall be submitted to the Committee on Appropriations, House of Representatives. When required by the OMB, SF 133 reports are submitted monthly directly to the OMB examiner, in addition to the electronic submission through FACTS II.

0406 DIRECT LOANS

Obligation of subsidy shall be recorded in the program account when a binding contract has been signed, in accordance with the provisions of [OMB Circular A-11, Part 5, Federal Credit](#). Subsidy funds shall be paid from the program account to the financing account when the direct loan is to be disbursed to the borrower. Note that the subsidy is not recalculated at the time of loan disbursement. Rather, any change in estimated subsidy caused by an interest rate

change or change in estimates for other components of subsidy cost, is made at the beginning of the fiscal year after the fiscal year in which the loan is disbursed. If, at that time, the subsidy amount increases, permanent indefinite budget authority is available to fund the increase, pursuant to section 504(f) of the "[Federal Credit Reform Act of 1990.](#)" If the subsidy amount decreases, a payment shall be made to a receipt account.

0407 GUARANTEED LOANS

Obligation of subsidy shall be recorded in the program account when a binding contract has been signed, in accordance with the provisions of [OMB Circular A-11, Part 5, Federal Credit.](#) Subsidy funds shall be paid from the program account to the financing account when the guaranteed loan is disbursed to the borrower by the third-party lender. Note that the subsidy is not recalculated at the time of loan disbursement. Rather, any change in estimated subsidy caused by an interest rate change or change in estimates for other components of subsidy cost is made at the beginning of the fiscal year after the fiscal year in which the loan is disbursed. If, at that time, the subsidy amount increases, permanent indefinite budget authority is available to fund the increase, pursuant to section 504(f) of the "Federal Credit Reform Act of 1990." If the subsidy amount decreases, a payment shall be made to a receipt account.

0408 COMPUTATION OF INTEREST EXPENSE AND INTEREST INCOME.

040801. Instructions for Computations of Interest Expense and Interest Income for Direct and Guaranteed Loan Programs

A. Interest expense in a direct loan program results from borrowing from the U.S. Treasury. As each loan is disbursed by the financing account to the individual borrower, subsidy funds are transferred from the program account to the financing account. Consequently, each loan disbursement is financed by two sources--subsidy transfer and borrowing from the U.S. Treasury.

B. A single borrowing from the U.S. Treasury is made at the beginning of each fiscal year, separately for each cohort, based on the estimated net loan disbursements for the cohort. Interest expense accrues on the borrowing, and interest income accrues on the undisbursed balance of the borrowing from the U.S. Treasury. (The undisbursed balance of U.S. Treasury borrowing is held as uninvested funds and earns interest.) The interest rate earned on the uninvested funds equals the interest rate paid on borrowing from the U.S. Treasury.

040802. Frequency of Interest Computations

OMB has determined that most credit programs do not have a seasonal bias in their loan disbursement patterns. Consequently, interest expense and income calculations for cohorts that currently are disbursing shall be based on an assumption that the actual loan amounts disbursed during the year were disbursed equally throughout the four quarters. The assumption allows agencies annually to compute interest expenses and interest income, at the end of each fiscal year, using the average annual interest rate provided by OMB and the U.S. Treasury. In those few

programs that have a strong seasonal pattern, OMB will calculate special weighted average interest rates appropriate to these patterns and will provide them to the agencies.

040803. Weighted Average Interest Rate

The Credit Reform Act provides that the interest rate for borrowing shall be assigned based on the U.S. Treasury rate in effect during the period of loan disbursement. Many individual loans are disbursed in segments over several quarters or even years. Consequently, several interest rates can be applicable to an individual loan. To simplify the recordkeeping, a single weighted average interest rate is maintained for each cohort and is adjusted each year, until 90 percent of the disbursements from the cohort have been made. Each year the current year average annual interest rate is weighted by current year disbursements, and then merged with the prior year's weighted average, to calculate a new weighted average. Additional information regarding subsidy calculation is contained in [OMB Circular A-11, Part 5, "Federal Credit."](#)

040804. Procedure and Due Dates for Computing Interest Expenses and Income Related to Borrowing for Direct Loan and Guaranteed Loan Financing Accounts

Detailed instructions for calculating interest due to and due from the U.S. Treasury are provided in Volume 1, Part 2, Chapter 4600 of the Treasury Financial Manual, available at <http://www.fms.treas.gov/tfm/vol1/v1p2c460.html>. Interest payments must be paid to the U.S. Treasury on the SF 1081, "Voucher and Schedule of Withdrawal and Credits," not later than the last business day of the fiscal year. Requests for interest due from the U.S. Treasury on uninvested financing account balances must be submitted to the Treasury Department not later than the third business day after the close of the fiscal year.

*0409 Credit Reform USSGL Accounts and Definitions

Credit reform accounts and definitions were established in the USSGL to implement requirements of the "Federal Credit Reform Act of 1990," (as amended), and are intended to account for direct [loans and loan guarantees](#). The approved Chart of Accounts and definitions are contained in USSGL Treasury Financial Manual, Sections I and II, which is published and maintained on the [Treasury Financial Management Service web site](#).