Memorandum

Direct Loans and Loan Guarantees Disclosures

February 5, 2025

To: Members of the Board

From: Brian Robinson, Analyst and Domenic Savini, Assistant Director

Thru: Monica Valentine, Executive Director

Subject: Direct Loans and Loan Guarantees Disclosures (Project Plan) Topic F

OBJECTIVE

The objective of this session is for the Board to consider and approve the attached project plan for the *Direct Loans and Loan Guarantees Disclosures reexamination project*, so that staff may continue research and take action on the next agreed-upon steps.

REQUEST FOR FEEDBACK BY FEBRUARY 20, 2025

Prior to the Board's February meeting, please review the attached project plan and respond to the questions by February 20, 2025.

Please submit responses to both Brian and Dom at robinsonBM@fasab.gov and savinid@fasab.gov with a cc to ValentineM@fasab.gov

NEXT STEPS

Pending Board approval of the project plan, staff will continue research and organize a task force to assist with the project.

ATTACHMENTS

1. Project Plan
2. Appendix – FY 23 Loan Note Disclosure Analysis
3. Preliminary Research presented at June 2024 meeting

Direct Loans and Loan Guarantees Disclosures

PROJECT PLAN

February 2025

Why is a project on the disclosure of Direct Loans and Loan Guarantees needed?

- Loan disclosures have become lengthy and convoluted for both preparers and users.
- Stakeholders believe loan disclosure requirements should be reassessed to improve, clarify, and streamline required note disclosures.
- Stakeholders believe there are opportunities to streamline and simplify disclosure requirements to help reduce preparer burden.

What questions / issues does this project plan address?

- How well do the disclosure requirements meet the objectives of federal financial reporting and the qualitative characteristics of financial reporting?
- Are stakeholder needs being met by the current direct loan and guarantee disclosure requirements?
- Are there areas where direct loan disclosure /guarantee guidance can be streamlined, eliminated, or enhanced?

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PROJECT PLAN

Purpose: This project is being undertaken by FASAB because federal reporting entities' direct loans and loan guarantees note disclosures as required by GAAP[1] have become very lengthy with numerous schedules and narratives spanning many pages. This has put additional burden on preparers, auditors, and users of agency reports. As part of FASAB's overall reexamination of existing standards, the Board will consider ways to improve, clarify, and streamline required note disclosures and reduce preparer burden regarding loan note disclosures.

Applicability: This project applies to all federal entities that present general purpose financial reports in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Objectives: The primary objectives of the Direct Loan and Loan Guarantee Disclosures project are to:

a). Determine if the current FASAB direct loan and loan guarantee disclosure requirements are relevant and meet the needs of stakeholders.

b). Determine areas where direct loan and loan guarantee disclosure requirements can be improved, clarified, and streamlined to reduce burden on preparers, auditors, and users.

c). Determine ways to increase the meaningfulness of the direct loan and loan guarantee disclosures to users and other stakeholders. For example, determine if there are ways to improve the presentation and format.

d). Determine if certain direct loan and loan guarantee disclosure information would be better suited for Required Supplementary Information (RSI).

Concepts to Guide the Board and Relevant Standards The following concepts will guide the Board on the Direct Loans and Loan Guarantees Disclosures project:

- SFFAC 1: *Objectives of Federal Financial Reporting*
- SFFAC 2: *Entity and Display*
- SFFAC 6: *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*
- SFFAC 8, *Federal Financial Reporting*

[1] The majority of direct loans and loan guarantees note disclosure requirements are derived from SFFAS 2 *Accounting for Direct Loans and Loan Guarantees* as amended by SFFAS 18 *Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* and SFFAS 19 *Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2*.

- SFFAC 10: *Omnibus Concepts Amendments 2024: Amending SFFAC 2 with Note Disclosures and MD&A Concepts and Rescinding SFFAC 3*

The following existing standards will be considered:

- SFFAS 2, *Accounting Standards For Direct Loans and Loan Guarantees*
- SFFAS 18, *Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2*
- SFFAS 19, *Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2.*

The following Technical Releases[2] will also be considered:

- Technical Release 3, *Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*
- Technical Release 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*

Assigned staff: Brian Robinson and Domenic Savini

Other resources: Staff plans to use a task force to include preparers, auditors, users and consult credit reform subject matter experts across the federal financial community.

[2] Technical Releases are not included in the reexamination project because FASAB's Rules of Procedure authorize the ASIC (formerly the AAPC) to issue Technical Releases related to existing federal accounting standards. It is anticipated that the ASIC would begin a similar project to conform all TRs to be consistent with revisions to existing standards that result from the reexamination project.

Timeline[3]:

1: Preliminary Research Q1 FY25
Conduct literature review, case file research, analysis of the FY23 SFFAS 2 Note disclosures, Congressional staff interviews including coordination with GAO, Congressional Research Service and the Congressional Budget Office.

2: Initiate Project Q2 FY25
Develop project plan and additional research necessary for development of the plan.

3: Research Phase Q2 FY25 – Q4 FY25
Form a task force, perform expanded research as necessary and prepare research memo(s) documenting results and recommendations.

4: Development Phase Q1 FY26 – Q3 FY26
Develop issue paper(s) that addresses matters identified and any other steps to ensure project objectives are addressed. Seek tentative Board decisions on each of the issue(s).

5: Exposure Draft & Comment Period Q4 FY26 – Q2 FY27
Develop exposure draft (ED) based on Board decisions. Address Board comments and feedback. Document will move to pre-ballot and ballot draft. Once ED is approved, ED will be released for comment.

6: Resolution & Finalization Phase Q3 FY27 – Q2 FY28
Analysis of comment letters. Project manager presents staff analysis and summary of respondent feedback and recommendations. Board (re)deliberates areas. Project manager prepares proposed Draft Statement incorporating Board decisions. Address Board comments and feedback. Document will move to pre-ballot and ballot draft. Once approved, it is transmitted to sponsors for 90-day review.

[3] Staff advises that the proposed timeline will be subject to change since the project and ensuing proposed guidance (1) will need to be coordinated with key stakeholders that may include Congress, federal entities and subject-matter experts, and (2) given the project's relative importance and broad interest among the financial management community. Further, the timeline may change due to the identification of new issues and Board requests, as well as circumstances that may beyond staff's control. **Staff will include an updated timeline that includes key Board decisions by meeting as an Appendix to all briefing memos.**

APPLICABLE GUIDANCE

FASAB's Existing Guidance:

The following are relevant Standards and Concept Statements that will be considered when developing guidance on the Direct Loans and Loan Guarantee Disclosure project. For each, staff provides an overview of key points that will be further developed during the project.

- **SFFAC 1: *Objectives of Federal Financial Reporting***, provides the four objectives of federal financial reporting. These reporting objectives are 1) budgetary integrity, 2) operating performance, 3) stewardship, 4) systems and controls. These reporting objectives are useful when considering which loan disclosure requirements should still be required and the current loan disclosure information needs of AFR users. The guidance in this concept statement is also useful when weighing user credit reform needs and the burden other stakeholders face when preparing and auditing this information.
- **SFFAC 2: *Entity and Display***, provides guidance for considering whether financial information is Basic, RSI, or OAI. Table 1 in SFFAS 2 contains factors to consider when distinguishing basic information from RSI. This guidance will be useful when considering the content and presentation of direct loan and loan guarantee disclosures.
- **SFFAC 6: *Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information***, provides a process and factors the Board considers when deciding whether the information should be considered basic information, required supplementary information (RSI), or other accompanying information (OAI). Table 1 in SFFAS 6 contains factors to consider when distinguishing basic information from RSI. This guidance will also be useful when considering the content and presentation of direct loan and loan guarantee disclosures.
- **SFFAC 8, *Federal Financial Reporting***, provides guidance on the role of financial statements, generally accepted accounting principles and principles relevant to financial statements, and role of RSI. This guidance will also be useful when considering the content and presentation of direct loan and loan guarantee disclosures.
- **SFFAC 10: *Omnibus Concepts Amendments 2024: Amending SFFAC 2 with Note Disclosures and MD&A Concepts and Rescinding SFFAC 3***, provides guidance on the types of information to be reported in the note disclosures. This guidance will be useful when considering what loan information is necessary to be presented in the credit reform note disclosure.
- **SFFAS 2, *Accounting Standards For Direct Loans and Loan Guarantees***, provides accounting guidance for Direct Loans and Loan Guarantees. The intent of this standard was to require the present value basis for loans which is consistent with the Federal Credit Reform Act (FCRA) of 1990. This standard contains several loan disclosure requirements.

- **SFFAS 18, *Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2*,** amends SFFAS by providing more expansive credit reform loan disclosure requirements. Some of the requirements added in SFFAS 18 are detailed subsidy allowance reconciliations and credit subsidy information and narratives. SFFAS 18 in the standard that has most of the credit reform disclosure requirements.
- **SFFAS 19, *Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2*,** amends SFFAS 2 by providing clarification on certain principles and measurement methods such as defaults costs and effective interest rates of direct loans and loan guarantees.
- **Technical Release 3, *Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*,** provides auditors guidance on how to audit credit subsidy information reported by agencies. This Technical Release contains information on planning the credit subsidy audit, testing internal control, and substantive testing of subsidy estimates. This TR is important to consider when evaluating the level of effort it takes for auditors to audit credit subsidy information.
- **Technical Release 6, *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*,** provides guidance for agencies in preparing and reporting credit subsidy estimates. The Technical Release also discusses and clarifies OMB's role in the credit subsidy process. This TR is important to consider when evaluating the burden agencies and preparers face when preparing credit reform note disclosures.

Other Guidance:

- **OMB Circular A-136, Financial Reporting Requirements**, provides form and content guidance to agencies to report credit reform note disclosure information. OMB has added additional loan disclosure requirements for agencies that are not specifically required in the standards.[4]

[4] An analysis of the sources of loan disclosure requirements is found in the attached appendix.

Resources

Staff plans to utilize a task force and subject matter experts to accomplish this project. The task force would be composed of individuals (preparers, auditors, academics, and users across the federal financial management community experienced in accounting for federal credit programs. The task force would have federal and nonfederal involvement.

Research Steps

- Review FASAB historic files
- Review existing accounting literature (FASAB and others)
- Consider key terms and definitions
  - Determine most appropriate terms to be used.
  - Determine which terms, if any, need to be defined or clarified.
- Gather and consider other research information
  - Financial reports
  - Government-wide guidance
- Meet with stakeholders
  - Representatives at GAO, OMB and Treasury
  - federal work groups and other offices as appropriate
  - other standard setters
  - stakeholders
  - oversight committees to understand Congress's view
- Meet with subject matter experts (SMEs) such as Congressional Budget Office and Congressional Research Service
- Determine if educational sessions may be necessary
- Organize a task force
  - Consider composition and roster of both federal and non-federal
  - Develop task force objectives and plan
  - Report task force results to the Board
- Conduct a roundtable meeting or other meeting for research
- Perform a pilot or field test with a selected number of agencies.
- Determine if case studies, flowcharts or other illustrations would be helpful.

POTENTIAL PROJECT MANAGEMENT CONCERNS

Implementation and Integration

- Differences between OMB and FASAB guidance - coordinate changes and ensure OMB A 136 is consistent.
- Scope of the project/ Scope creep – purpose is to reexamine disclosures, but this process may identify other areas that should be reexamined in SFFAS 2.
- Consider more principle-based disclosures and offer more flexibility.
- Complexities- credit reform is a complicated area and there are few subject matter experts. Therefore, there is an increased burden on those few subject matter experts.
- Pre-1992 loan disclosures- how material are they. The Board considered the expected costs and efforts that would be required in restating pre-1992 loans at present value. Based on this consideration, the standards permit but do not require restating those loans and loan guarantees on a present value basis.

Question for the Board:

Does the Board generally agree with the proposed Direct Loans and Loan Guarantee Disclosure project plan? Please provide member suggestions for improvement and questions about the project plan as appropriate.

Appendix

FY23 Loan Note Disclosure Analysis

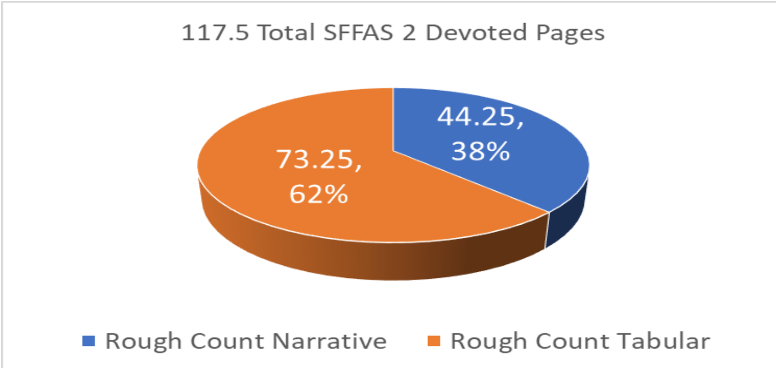
Staff Analysis

To understand what drives the loan/guarantee note disclosures in the FY23 agency reports, Staff performed an analytical review of each agency's annual financial report (AFR). For the FY23 reporting period, 12 CFO Act agencies[5] reported direct loans and loan guarantee information. Staff also included in its review two non-CFO Act agencies[6] that had a loan/guarantee note disclosure for FY23.

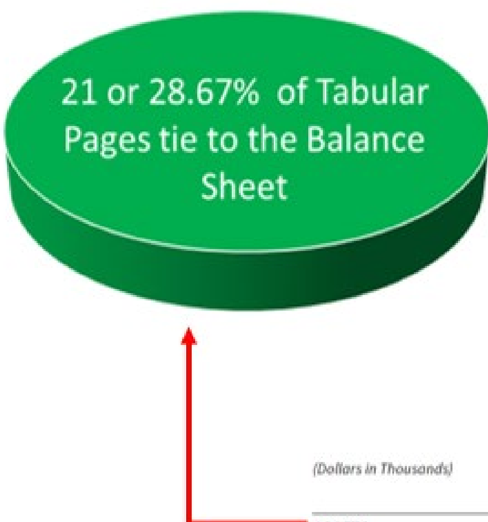
Page Count Analysis – Narrative vs. Tabular

	Agency with SFFAS 2 Note	Rough Count Narrative	Rough Count Tabular	Total Page Count
1	Agriculture	6.5	8	14.5
2	Commerce	1.5	5.5	7
3	Defense	2	7	9
4	Education	3.25	1.75	5
5	Energy	3	4	7
6	Homeland Security	1.75	2.25	4
7	Housing & Urban Development	5	9	14
8	Interior	2	5	7
9	Transportation	1	6	7
10	Veterans Affairs	4.25	3.75	8
11	Environmental Protection Agency	1.5	2.5	4
12	Export Import Bank	5	3	8
13	Development Finance Corporation	2.5	4.5	7
14	Small Business Administration	5	11	16
	Total	44.25	73.25	117.5
	Percentage	37.66%	62.34%	100.00%

[5] Agriculture, Commerce, Defense, Education, Energy, EPA, Homeland Security, Housing and Urban Development, Interior, Transportation, SBA, & Veterans Affairs
[6] Development Finance Corporation and Export Import Bank



Based on Staff's analysis, tabular information and schedules take up the most landscape in agency disclosures. The page count for most agencies falls in the 5 – 10 page-count range. The longest and most detailed note disclosures were from Agriculture, HUD, & SBA. Those agencies each had a 14+ page-count note disclosure. Please note that the narrative and tabular page-count for these agencies were in the following ratios of 6.5:8.0 for Agriculture; 5.0:9.0 for HUD; and 5.0:11.0 for SBA, respectively.



CONSOLIDATED BALANCE SHEET

As of September 30, 2023 and 2022

(Dollars in Thousands)

		2023
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note 2)	$	44,081,291
Advances and Prepayments		6,303
Total Intragovernmental		44,087,594
Other than Intragovernmental		
Cash and Other Monetary Assets (Note 3)		10,460
Accounts Receivable, Net (Note 5)		165,487
Loans Receivables, Net:		
Credit Program Receivables and Related Foreclosed Property, Net (Note 6)		271,944,994
General Property, Plant and Equipment, Net (Note 7)		103,995
Advances and Prepayments		16,054
Total Other than Intragovernmental		272,240,990
Total Assets	$	316,328,584

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Of all the agency tabular pages, only 28% tied directly to their respective balance sheet line items. Most of the tables reported information regarding subsidy costs/rates/expense of direct loans and loan guarantees which are not presented on the balance sheet and accordingly, do not directly articulate.

Our initial research suggests that subsidy tabular and narrative- information are some of the primary drivers of the length and complexity of loan/guarantee note disclosures. SFFAS 18[7] is the standard that requires agencies to disclose subsidy information. One of the main users the Board added subsidy disclosure requirements for was congressional staff that were involved in Federal credit programs. Staff will be conducting outreach to congressional staff, CRS, & CBO to determine if the current loan disclosures are still meeting their needs.

[7] SFFAS 18 Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2 and Statement of Federal Financial Accounting. SFFAS 18 requires agencies to disclose the following subsidy information: a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and loan guarantees, the subsidy expense and subsidy reestimates by components for each program, the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, defaults 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 years cohorts, and a narrative that discusses and explains 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 impact on subsidy rates, subsidy expense, and subsidy reestimates.

Tabular Analysis – Where do these requirements come from?

Schedules in Agency Note Disclosures	SFFAS	OMB	Non FASAB or OMB
Total Amount of Direct Loans Disbursed (Post-1991)	SFFAS 18		
Subsidy Expense for Direct Loan Programs by Component	SFFAS 18		
Direct Loans Modifications or Reestimates	SFFAS 18		
Total Direct Loan Subsidy Expense	SFFAS 18		
Subsidy Rates for Direct Loans by Program and Component	SFFAS 18		
Schedule for Reconciling Subsidy Cost Allowances Balances	SFFAS 18		
Guaranteed Loans Outstanding	SFFAS 2		
New Guaranteed Loans Disbursed	SFFAS 18		
Subsidy Expense for Loan Guarantees by Program and Component	SFFAS 18		
Guaranteed Loans Modifications or Reestimates	SFFAS 18		
Subsidy Rates for Loan Guarantees by Program and Component	SFFAS 18		
Total Loan Guarantee Subsidy Expense	SFFAS 18		
Schedule for Reconciling Loan Guarantee Liabilities Balances	SFFAS 18		
Direct Loans Obligated Prior to FY 1992		OMB A-136	
Direct Loans Obligated Post-1991		OMB A-136	
Defaulted Guaranteed Loans from Prior to FY 1992		OMB A-136	
Defaulted Guaranteed Loans from Post-1991 Guarantees		OMB A-136	
Liability for Loan Guarantees		OMB A-136	
Administrative Expenses		OMB A-136	
Loan Receivable		OMB A-136	
Summary of Direct Loans and Loan Guarantees			Agency
Direct Loan Disbursements by Loan Type			Agency
Program Loans and/or Guarantees Receivable			Agency
Loan Guarantees Obligated			Agency
Program Cost and Reestimates Expense - Direct Loans			Agency
Program Cost and Reestimates Expense - Guarantees			Agency
Allowance and Exposure Summary			Agency
Statutory Limits on Spending			Agency
Other Credit programs, Loans Receivable			Agency

There was a total of 29 tables/schedules reported by the 14 agencies that were part of the analytical review in FY23. Staff analyzed requirements in SFFAS 2, SFFAS 18, SFFAS 19, & OMB A-136 to identify the source of the tables reported in the credit agencies AFR's. Staff identified 13 tables that were required to be disclosed by SFFAS 2 & SFFAS 18. OMB A-136 required 7 additional tables to be disclosed that were not specifically required in the standards. The remaining 9 tables were additional information the agencies chose to voluntarily include in their note disclosure.

Preliminary SFFAS 2 Research

At the December 2023 meeting, the Board acknowledged that there were limited responses from major federal credit entities to the Invitation to Comment (ITC). The Board asked staff to reach out to federal credit reporting entities to assess their concerns with SFFAS 2, *Accounting for Direct Loan and Loan Guarantees*. Specifically, the Board asked staff to assess reporting entity concerns with the preparation of loan note disclosures.

Examples of federal credit programs include farmers' home loans, small business loans, veterans' mortgage loans, and student loans.

Background

Due to the complexity, FASAB staff believes it important to provide a short over of the existing FASAB standards. SFFAS 2 was issued in August 1993 but then was amended by Statement of Federal Financial Accounting Standards 18: *Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2* and Statement of Federal Financial Accounting Standards 19: *Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2*. In addition, the AAPC has provided Technical Release 3: *Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* and Technical Release 6: *Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act.*

SFFAS 2 was issued to provide accounting standards for federal direct loans and loan guarantees. SFFAS 2 was based on the Federal Credit Reform Act of 1990 (FCRA).[8] The Federal Credit Reform Act of 1990 requires that effective October 1, 1991, the cost of direct loans and loan guarantees be estimated at present value for the budget. In developing SFFAS 2, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 and to make financial reporting compatible with the budget.

SFFAS 2 provides for the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The accounting standards are applied to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. The present value accounting as required by SFFAS 2 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.

[8] As explained in SFFAS 2, paragraph 6, the primary intent of the Federal Credit Reform Act of 1990 is to "to ensure that the SUBSIDY COSTS of direct loans and LOAN GUARANTEES are taken into account in making budgetary decisions. To achieve this general result, the Act has the following specific purposes: (a) ensure a timely and accurate measure and presentation in the President's budget of the costs of direct loan and loan guarantee 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."

Further, SFFAS 2 requires that post-1991 direct loans be recognized as assets at the present value of estimated net cash inflows. Loan Guarantees are recognized as a liability at the present value of estimated cash outflows. The credit subsidy expense is the present value of estimated cash outflows minus the present value of cash inflows discounted at the interest rate of marketable securities. Both direct loans and loan guarantees have subsidy expense. SFFAS 2 permits pre-1992 loans to be reported using the allowance for loss method. For pre-1992 direct loans the nominal amount is reduced by the allowance for uncollectible amount. Pre-1992 loan guarantees are reported as liabilities when it is more likely than the not the reporting entity will have to use a future outflow of cash to pay default claims.

During 1998 and early 1999, the Board discussed issues related to reporting the credit subsidy expense and credit subsidy reestimates in general. The Board concluded that certain portions of SFFAS 2 should be amended so that more useful information on credit programs' subsidy costs and performance would be provided to citizens, Congress, program managers, and other users of Federal financial information.
It was determined that SFFAS 2 had limited disclosure guidance and therefore, the Board issued SFFAS 18 to amend SFFAS 2 to provide more information on credit subsidy costs and performance. SFFAS 18 requires federal entities to "(a) report subsidy reestimates by component, (b) display in a note to financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, and (c) provide disclosure and discussion that would help the reader understand the changes in Federal credit programs' subsidy costs and performance."

Based on staff's review of FASAB's historical files, staff notes that stakeholders were consulted in the Board deliberations in determining information to include in the federal entity financial reports. Specifically, congressional staff members who had been involved in Federal credit programs indicated they needed more rather than less detailed data on the credit subsidy costs for direct loans and loan guarantees.

In response to those deliberations, the Board issued SFFAS 19 for the following purposes (1) to clarify that the cash flow discount method used in SFFAS 2 is consistent with the method required by FCRA, (2) 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, and (3) to clarify the measurement principle for the default costs of direct loans and loan guarantees.

As a result of the above, federal entity loan note disclosures have become very lengthy due to the required loan note disclosures. Most entity loan note disclosures span 5-10 pages, with certain entity loan note disclosures up to 14 pages. The information presented in these disclosures are very detailed, complex, and comprehensive. There are questions as to whether all the information presented is still necessary and useful to the reader.

Staff Outreach

As part of the reexamination project, FASAB staff reached out to the major federal credit reporting entities to assess their concerns with SFFAS 2 and to discuss their issues and challenges when preparing entity loan note disclosures. Staff reached out individually to each entity to gain their feedback and then held a round table with the major Federal Credit Reform Act entities in April 2024. The round table was attended by representatives from the Department of Housing and Urban Development, Small Business Administration (SBA), Department of Agriculture, and Department of Veteran's Affairs.[9]

The primary objective of the round table was to discuss ways to potentially improve, clarify, or expand reporting entity direct loan and loan guarantee note disclosures. FASAB staff asked entity representatives to discuss issues/challenges that the entities face when preparing loan/loan guarantee note disclosures, as well as ideas on how the required loan/loan guarantee note disclosures could be streamlined and/or eliminated. The meeting also provided an opportunity for representatives to discuss areas in the existing Direct Loan and Loan Guarantee accounting guidance that could be improved, clarified, or expanded.

In May staff also spoke with a Government Accountability Office staff member with vast experience auditing SFFAS 2 requirements to gain further credit reform insights. Those insights have been incorporated into this research paper.

In summary, FASAB staff's outreach and preliminary research into SFFAS 2 direct loan and loan guarantee note disclosures provided valuable feedback. Staff discussions with ITC and roundtable respondents revealed areas where stakeholders believe guidance can be improved or streamlined.

Various Sources of Potential Preparer Burden

<u>Complexity</u>

Round table respondents also mentioned that credit reform is a complicated area and there are few subject matter experts. Therefore, there is an increased burden on those few subject matter experts. Further the need to separately account for the direct loans or loan guarantees obligated or committed by each credit program in a fiscal year by cohort can be quite cumbersome. As years go by, the number of cohorts normally multiply. As a result, entities use numerous spreadsheets to keep track of the many cohorts. For example, one entity with 20 programs has up to 600 spreadsheets to account for the different loan cohorts. Aggregating cohorts as loan balances decrease was discussed by the participants as a possible solution, but this would require consideration of changes to the FCRA.

<u>Narrative</u>

Several respondents explained that the required narrative portions of the disclosures should be reassessed. Specifically, participants questioned the need for the narrative disclosure requirements in SFFAS 18 par. 11(C). SFFAS 18 par. 11(C) requires

9 Although the Department of Education is a major credit reform entity and FASAB staff invited representatives to participate, Education did not participate in the round table meeting.

"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." For example, changes in projections of cash inflows and outflows impact subsidy reestimates. There is a clear line between economic conditions and subsidy expense and subsidy reestimates. However, a respondents explained there is not a clear connection between economic conditions and loan subsidy rates.

Another stakeholder mentioned that entities are having difficulties preparing concise and meaningful narratives. The stakeholder noted that entity narratives are very general and need to focus on the key drivers of the changes in subsidy costs.[10] This point confirms some of the challenges entities are having when preparing narratives to comply with the disclosure and discussion requirement in SFFAS par. 11(C). The stakeholder also discussed materially provisions for entities providing descriptions of their loan programs. One stakeholder mentioned that some entities are including 3-4 pages of descriptions for their loan programs when some of these programs have immaterial amounts.

Required Reconciliation

Another respondent mentioned that the required subsidy cost allowance reconciliation[11] is cumbersome to prepare. Specifically, the participant highlighted that the reconciliation for loan guarantees subsidy cost allowance balances requires additional support and is complicated. Another respondent questioned the value to readers. Furthermore, some questioned the value added in the financial reports. One respondent mentioned that they viewed the required reconciliation as beneficial for the reader but could be streamlined to provide more concise information to the users.

Loan Disclosures that can be Streamlined

Pre-1992 Loan Disclosures

Pre-1992 direct loans and loan guarantees refers to direct loans obligated and loan guarantees committed before October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. Stakeholders believe that the Board should reexamine the need for pre-1992 loan note disclosures. Entities are currently disclosing their pre-1992 direct loan and loan guarantees in separate schedules from post-1991 credit reform loans. Entities are also including a short narrative explaining pre-1992 loans are prepared under the allowance for loss method. Respondents noted that the pre-1992 loan balances are mostly immaterial and adds to the entities' note disclosures. Respondents also questioned the meaningfulness of reporting pre-1992 loans given that in many instances the amounts are not material and may not be as relevant as

[10] In the Basis for Conclusions to SFFAS 18, the Board stated its primary intent for the disclosure and discussion requirement is to discuss significant changes in subsidy rates and reestimates. Events that have occurred and will have a significant impact on subsidy rates should be discussed.

[11] This reconciliation is required by SFFAS 18 and it "displays activities that affect the subsidy cost allowance or the loan guarantee liability, such as the subsidy expense for direct or guaranteed loans disbursed during the reporting period, subsidy reestimates, fees received, interest supplements paid, loans written off, claim payments made to lenders, recoveries obtained, and other adjustments."

current loan programs that are reported under FCRA. Although materiality should be considered by preparers, participants suggested the Board possibly including explicit language allowing preparers to consider materiality for pre-1992 loan note disclosures. The participants suggested the Board may want to provide an alternative for presenting pre-1992 loan note disclosures if necessary, such as merging them into one line under the FCRA presentation. Another option suggested by respondents would be to allow some flexibility to entities in determining what disclosures would be most useful to the report users.

Staff notes that the Board considered the expected costs and efforts that would be required in restating pre-1992 loans at present value. Based on this consideration, the standards permit but do not require restating those loans and loan guarantees on a present value basis. Specifically, paragraph 40 of the standard provides:

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

Loan Modifications

One respondent suggested that some of the required disclosures for loan modifications[12] could be streamlined or eliminated. Specifically, the respondent questioned the usefulness of the loan modification disclosures required in SFFAS 2 par. 56 to the users of the financial statements. For example, SFFAS 2 par. 56 requires disclosure of the nature of the modification, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification.

The respondent suggested that there should be more flexibility and allow judgment by the preparer and the external auditors to determine what pertinent information is useful to the reader of the agency financial report (AFR) regarding modifications. For example, the participant questioned if the inclusion of the discount rates or the basis for gain or loss recognition provide useful information to an external reader of the AFR.

Subsidy Rate Information

A stakeholder highlighted the potential redundancy of the inclusion of the schedule for the subsidy rates for each loan program in the note disclosure. Subsidy rates for loan programs are published annually in *The Federal Credit Supplement, Budget of the U.S. Government*.[13] Further research would need to be done to assess if financial report users still need the subsidy rates by program schedule.

[12] Loan Modification as defined in the standards “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.”

[13] Staff notes the Basis for Conclusions to SFFAS 18 explains the Board was aware that the budget subsidy rates are published in the Federal Credit Supplement to the Budget of the U.S. Government. The Board the inclusion of those subsidy rates in the financial reports will provide the reader of the financial statements with an easy access to the budget data. Further, the disclosure of budget subsidy rates was initially proposed by the AAPC Credit Reform Accounting Task Force.

In addition, a stakeholder suggested that the subsidy expense by component schedule could potentially be a candidate for removal if users are not finding it meaningful.

Opportunities to Increase Meaningfulness of Loan Disclosures

Negative Loan Guarantees

Several stakeholders mentioned a gap in guidance regarding negative loan guarantees[14]. Per FASAB guidance loan guarantees are recorded as a liability on the balance sheet. The existing standards do not address how reporting entities should report loan guarantees when they are negative. Reporting entities are currently following OMB A-136 guidance to report negative loan guarantees as an asset on the balance sheet. Respondents believed that GAAP guidance on reclassification of the liability (negative) to an asset would be helpful. In addition, the respondents believed that guidance should also address if additional disclosures would be needed to explain the reclassification. Stakeholders believe additional guidance and disclosures regarding negative loan guarantees would provide benefits to preparers as well as users of the financial reports.

Guidance on the Objectives of Loan Note Disclosures

A stakeholder suggested the Board consider providing more guidance on the intended objectives of the loan note disclosures. The stakeholder believes this would result in a decrease in some of the preparer's challenges when preparing these disclosures and increase the meaningfulness of the users of financial reports. For example, stakeholders would like more explicit materiality guidance and its application in note disclosures. Another stakeholder called for more discussion and narrative guidance for preparers. Several preparers questioned how meaningful for the users the current loan disclosures were in the round table.

Increasing Preparer Flexibilities

As mentioned earlier in the paper several respondents sought more flexibility in preparing the loan disclosures. Some respondents mentioned explicit materiality language in regard to disclosure of pre-1992 loans and loan program narratives. Respondents also think these increased flexibilities could result in streamlined disclosures. As discussed, most reporting entities disclosures are 5-10 pages composed of schedules and narratives.

Additional Round Table Insights for Board's Consideration

SBA raised concerns about fraud and its impact on accounting and reporting on direct loans and loan guarantees. FASAB loan guidance currently does directly discuss fraudulent loans' impact in SFFAS 2. SBA believes the financial environment has changed and believes more guidance in this area is necessary. FASAB responded to a technical inquiry in 2023 sent by SBA regarding this topic.

[14] Negative loan guarantees result when the net present value of expected inflows exceeding net present value of expected outflows.

Participants also suggested the Board consider activity on loans that have been approved, but not yet disbursed. Participants explained that although cost activity occurs for these loans, SFFAS 2 provides the liability is not recognized until loans have been disbursed. Participants believe not including these costs on the financial statement may be misleading to the users of the reports.

Staff Note: This paper provides a summary of the preliminary research. Staff is not requesting Board deliberation on any of the specific technical issues presented, as this is preliminary research to facilitate the prioritization of reexamination topics. As such, there are no specific recommendations by staff.