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CREDIT REFORM

Greater Effort Needed to Overcome Persistent Cost Estimation Problems





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

Accounting and Information
Management Division

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The Honorable Pete V. Domenici
Chairman, Committee on the Budget
United States Senate

Dear Mr. Chairman:

The Federal Credit Reform Act of 1990¹ was enacted to require that the budget reflect a more accurate measurement of the government's subsidy costs for federal direct loans and loan guarantees and to permit better cost comparisons both among credit programs and between credit and non-credit programs. The credit subsidy cost is the government's estimated net cost, in present value terms, of direct or guaranteed loans over the entire period the loans are outstanding. Because the government now has over 6 years of experience with credit reform, you asked us to determine (1) whether agencies completed estimates and reestimates of subsidy costs, (2) whether we could readily discern any trends including improvements in subsidy estimates, and (3) whether we could readily identify the causes for changes in subsidy estimates. You also asked us whether agencies with discretionary credit programs initially underestimated credit subsidy costs in response to the incentive created by the availability of permanent, indefinite budget authority for credit reestimates.²

We reviewed subsidy estimates and supporting documentation prepared for two domestic credit programs at each of the five largest credit agencies—the Departments of Agriculture (USDA), Education, Housing and Urban Development (HUD), and Veterans Affairs (VA), and the Small Business Administration (SBA). Each of the agencies confirmed that the reported data were an accurate reflection of the data they had. While we did not independently verify that data, we found, and agency staff later agreed, that there were problems with these data, as discussed later in the report. The causes of changes in subsidy estimates reported in appendix II are those identified by credit agencies' staff.

Background

There is a long history of problems with federal credit programs. We reported many of the problems, such as poor recordkeeping and cost data,

¹Appendix I contains a summary discussion of credit reform requirements.

²Initial estimates of subsidy costs compete under caps, while subsidy reestimates are covered by permanent, indefinite budget authority.

prior to credit reform.³ For example, we reported in November 1989 that federal agencies' long-standing deficiencies in financial management systems and accounting procedures had precluded accurate, comprehensive recording and reporting of the full extent of credit losses.⁴ Agencies have had perennial problems tracking loan payments due and loan guarantees made in federal budgets. Also, prior to credit reform, the cash-based budget distorted choices between direct loans and loan guarantees. A direct loan initially looked like a grant since the budget included as a cost the face value of a direct loan, ignoring that at least some part of the loan would be repaid. Conversely, loan guarantees looked free when they were made because the budget ignored the fact that some would result in default costs. The Office of Management and Budget (OMB), GAO, the Congressional Budget Office (CBO), and others reported on the need to change the way credit programs were budgeted.

In response to these reports and a growing recognition of federal financial management problems, the Congress enacted a series of laws designed to improve financial management and the quality and use of cost data in decision-making. To address the deficiencies in recognizing the cost of credit programs, the Federal Credit Reform Act of 1990 was enacted as part of the Omnibus Budget Reconciliation Act of 1990. Credit reform was intended to ensure that the full cost of credit programs would be reflected in the budget so that the executive branch and the Congress might consider these costs when making budget decisions. Accounting standards for credit programs were developed to be consistent with the intent of this act. To address broader problems in federal financial management, the Chief Financial Officers (CFO) Act of 1990 required the development and maintenance of integrated agency accounting and financial management systems, including financial reporting and internal controls, that provide for development and reporting of cost information. The Government Management Reform Act of 1994 expanded the CFO Act to provide for audits of the annual financial statements of the 24 CFO agencies. The largest credit programs are found in these agencies and audits include a review of agencies' subsidy estimates and actual loan performance data. Accurate cost information also is key to improvements in the efficiency and effectiveness of federal programs as envisioned by the Government Performance and Results Act of 1993. The Debt Collection Act of 1982 provided for OMB to require agencies to report debt information to OMB and

³Financial Management: Additional Actions Needed to Improve Federal Financial Management Systems (GAO/AFMD-90-14, April 27, 1990) and Financial Audit: Veterans Administration's Financial Statements for Fiscal Years 1987 and 1986 (GAO/AFMD-89-23, November 30, 1988).

⁴Federal Credit and Insurance: Programs May Require Increased Federal Assistance in the Future (GAO/AFMD-90-11, November 16, 1989).

to the Department of the Treasury. Finally, the Debt Collection Improvement Act of 1996 expanded collection tools and authorities available to agencies and called for centralized servicing of some debt. Federal financial management, including credit program management, continues to reap the benefits of these laws.

While all of these laws sought to improve federal financial management, a major change for budgeting was the Federal Credit Reform Act included in the Omnibus Budget and Reconciliation Act of 1990. This act changed the budgetary treatment of credit programs so that their costs could be compared more appropriately both with each other and with other federal spending. Credit reform requires agencies to estimate the net cost to the government over the full term of the credit of new direct or guaranteed loans to be made in the budget year and to record that cost in the budget on a present-value basis. Unless OMB approves an alternative proposal, agencies are required to reestimate this cost annually as long as any loans in the cohort⁵ are outstanding. The Balanced Budget Act of 1997 amended the Federal Credit Reform Act to simplify and clarify subsidy estimation requirements. OMB also has simplified guidance for credit subsidy estimation. Appendix I contains a more detailed description of credit reform requirements and recent changes.

Credit programs may be either discretionary⁶ or mandatory⁷ as defined in the Budget Enforcement Act of 1990. Appropriations for the subsidy cost of discretionary credit programs are counted under the discretionary spending caps and so must compete with other discretionary programs for the funding available under these limits. Like other mandatory programs, mandatory credit programs receive automatic appropriations for whatever amount of credit is needed to meet the estimated demand for services by beneficiaries.

All credit programs automatically receive any additional budget authority that may be needed to fund reestimates.⁸ For discretionary programs this

⁵A cohort includes those direct loans or loan guarantees of a program that are subsidized by an appropriation for a given fiscal year even if disbursements occur in subsequent years.

⁶Funding for discretionary spending programs is provided in appropriations acts.

⁷Mandatory programs generally are entitlement programs for which the amount of funding depends on eligibility and benefits rules contained in substantive law.

⁸It was recognized that data were limited or unreliable in the early years of credit reform. This could impede the ability of agencies to make reliable estimates. Permanent, indefinite budget authority for upward reestimates of subsidy costs was provided. Agencies with discretionary credit programs then could reestimate subsidy costs as required without being limited by the constraints of budgetary spending limits.

means there is a difference in the budget treatment of original subsidy cost estimates and of subsidy cost reestimates. The original estimated subsidy cost is counted under the discretionary caps, but any additional appropriation for upward reestimates of subsidy cost is exempt from the caps. This design could result in a tendency to underestimate the initial subsidy costs of a discretionary program. Portraying a loan program as less costly than it really is when competing for funds under the discretionary caps means more or larger loans or loan guarantees could be made with a given appropriation since the program then could rely on automatic funding for subsequent reestimates to cover any shortfalls. This built-in incentive is one reason to monitor subsidy reestimates. Monitoring reestimates is a key control over tendencies to underestimate costs as well as a barometer of the quality of agencies' estimation processes.

The development of credit reform requirements reflects in part decisionmakers' interest in analyzing the causes of changes in subsidy estimates. Understanding which of the components of subsidy expense—interest, net defaults, fees and other collections, and other subsidy costs—are the key drivers of reestimates can both improve the quality of estimates and yield insights into program operations. OMB developed and provided agencies with a computer model to calculate the total estimated subsidy rate and the components of subsidy expense based on agency-developed cash flow information. In the development of accounting standards for credit programs, the Federal Accounting Standards Advisory Board (FASAB) indicated that these data would be valuable for making credit policy decisions, monitoring portfolio quality, and improving credit performance.⁹ Current accounting standards and OMB guidance require agencies to recognize, and disclose in the financial statement footnotes, the four components separately for the fiscal year during which direct or guaranteed loans are disbursed. However, for programs that disburse over more than 1 year, the current disclosure aggregates subsidy component data for the current year with subsidy costs from prior years. In addition, changes in law and program administration often occur. Thus, loans disbursed from programs over multiple years have different program characteristics and the current year's financial statement disclosures do not represent the program characteristics or expenses of any given year of the program. Because the requirement in its present form does not provide the kind of useful information that was intended, FASAB now is considering revising these standards.

⁹FASAB was created by OMB, Treasury, and GAO to consider and recommend accounting principles for the federal government. It published Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct Loans and Loan Guarantees, in July 1993.

Agencies now have prepared eight budgets under credit reform requirements and there should be 6 years of actual data available. Because of different program requirements, resource and expertise levels, and levels of commitment and interest, agencies have taken different approaches to making subsidy estimates. Preparing subsidy estimates is complex for a number of reasons, including projecting cash flows many years into the future and assessing the effect of economic changes on a particular program and its borrowers. Further, in some—if not all—agencies, budget office staff must integrate information from staff and systems in both the finance and program offices. While the present value-based budgeting of credit reform is a major step forward, its success depends heavily on the quality of these complex subsidy estimates. The independent review of agency records and data in the annual financial audit is an important step in monitoring the subsidy estimates and improving their reliability.

When credit reform was enacted, it generally was recognized that agencies did not have the capacity to implement fully the needed changes in their accounting systems in the short run and that the transition to budgeting and accounting on a present-value basis would be difficult. However, policymakers expected that once agencies established a systematic approach to subsidy estimation based on auditable assumptions, present value-based budgeting for credit would provide them with significantly better information than the former cash-based system. Despite the difficulties with implementation, including current data problems, present value-based reporting for credit avoids a number of the problems of cash reporting. Therefore, we believe that making credit reform work is important.

Results in Brief

After over 6 years of experience with credit reform, agencies continue to have problems in estimating the subsidy cost of credit programs. The lack of timely reestimates as well as the frequent absence of documentation and reliable information limit the ability of agency management, OMB, and the Congress to exercise intended oversight. We found problems with the availability and reliability of subsidy estimates, reestimates, and supporting documentation in our cross-cutting review of 10 programs. None of the 10 programs in our study had for our review all of the required budget request, budget execution,¹⁰ and reestimate subsidy rates and supporting documentation for fiscal years 1992 through 1998. While

¹⁰The budget execution estimate is made after an agency receives an appropriation and when the agency obligates the government for a direct loan or makes a loan guarantee commitment.

documentation generally is more available in recent years, the availability of timely reestimates of subsidy rates did not improve over time. Of the 10 programs we examined, 8 either failed to do reestimates for certain years or produced them too late to be included in the next budget formulation or audit cycles. The subsidy costs of one program—the SBA Disaster Loan Program—were not reestimated for budgets or the financial statement audits during this period but were reestimated for the fiscal year 1999 Budget. The programs that did not make reestimates (HUD, USDA, and SBA) all received waivers from OMB.

Data used as the basis for subsidy estimates were not always reliable. In the audits of the fiscal year 1996 financial statements, three of the five largest credit agencies received disclaimers or qualified opinions related to their credit programs. Auditors were unable to find support for agency data on such items as delinquencies and prepayments for loans receivable and liabilities for loan guarantees. This also could reflect problems with historical data since agencies with loan guarantee programs rely on lenders or intermediaries for loan performance data. Moreover, we found—and agency officials acknowledge—discrepancies between the subsidy rates reported in the President’s Budget and those provided to us by the agencies as well as discrepancies within the data provided to us by the agencies. In other cases, agencies were unable to provide supporting documentation for the numbers in the Budget.

Problems with the reliability and validity of the underlying credit data raise questions about the basis for the subsidy estimates included in the Budget. Agencies have had several years to obtain and refine historical data and estimation methodologies. Over time, we would expect to find that, for a given cohort, the annual changes in reestimates due to technical factors would be smaller. Because component data were not available, we could not determine whether this had occurred. However, we did note that overall subsidy rates for a given cohort varied widely. For example, estimates and reestimates of the fiscal year 1992 cohort of Education’s Federal Family Education Loan Program (FFELP) changed direction each of the 6 years for which we had data—estimated subsidy rates ranged from 26.30 percent to 16.99 percent.

We observed a similar pattern of fluctuations in subsidy estimates at the program level. Subsidy rate estimates for any given program continued to fluctuate widely from year to year with no pattern or particular trend. For example, the subsidy estimates and reestimates of the fiscal years 1992 through 1997 cohorts in VA’s Loan Guaranty Direct Loan Financing

Account¹¹ changed direction in each of the 6 years of data and estimated subsidy rates ranged from 4.80 percent to 1.18 percent. Subsidy rate estimates can change for many reasons, including programmatic redesign and changes in the economy. For example, a change in the discount rate will cause the subsidy rate to change, even if the cash flows are unaffected. Financial statement audit findings for the credit agencies we reviewed would lead us to conclude that at least some of the fluctuations are caused by weaknesses in agency data used to develop the cash flow estimates.

The intersection of credit reform and the Budget Enforcement Act of 1990—that is, the fact that original subsidy appropriations must compete under the discretionary caps while reestimates are outside them—may offer an incentive for agencies with discretionary programs to underestimate subsidy costs initially to permit more loans or loan guarantees within a given appropriation level. If this incentive did not exist and absent any overriding economic trend or revision of historical data, one would expect reestimates to lower the original subsidy estimate as often as they raise it, and the patterns would be similar for discretionary and mandatory programs. However, available data were not sufficient to assess whether a credit program’s budgetary treatment affected its initial subsidy estimates. We found somewhat similar patterns when we compared discretionary and mandatory programs.¹² We found that the estimated subsidy rates for 8 of the 15 discretionary cohorts increased in the first reestimate following the initial appropriation, while first reestimates for 7 of the 12 mandatory cohorts decreased. This result is not conclusive. No real conclusions can be drawn from this observation about whether some discretionary programs may have sought to benefit from initially underestimating subsidy costs. Other factors such as changes in the economy—especially in interest rates—data errors, or more historical data may have contributed to changes in reestimates.

Better information on factors underlying changes in subsidy rates is needed to identify and understand why these estimates change. In theory, data on the four components of subsidy expense—interest, net defaults, fees, and other subsidy costs—calculated by the OMB subsidy model as part of the estimation process could be used to identify possible causes of

¹¹These estimates and reestimates were completed for the fiscal year 1997 President’s Budget.

¹²Mandatory and discretionary programs are treated differently under the Budget Enforcement Act. Discretionary programs compete under fixed-dollar caps. Mandatory credit programs are automatically funded for whatever amount of credit is needed for a given program design and set of program beneficiaries. As a result, for mandatory programs there would not be an incentive to initially underestimate subsidy costs.

changes. However, we could not perform such an analysis because component data frequently were missing or inaccurate. Accordingly, meaningful component data were not available to be used internally or by OMB for budget formulation or program management.

While OMB provides a user's guide and some training on the subsidy model, OMB has not provided agencies with clear definitions of each component or sufficient guidance on how to use the OMB subsidy model to correctly calculate the components. If OMB did so, agency staff could improve the consistency and accuracy of component data, making it useful for budget decision-making and oversight as envisioned by budget and accounting requirements. For example, we recently used the component data to identify a large error in SBA's subsidy estimates.¹³ Although SBA's component data were flawed, it provided a quick indication that there was an error in the fiscal year 1997 subsidy estimates for the section 7(a) General Business Loan Program. Correcting this error enabled SBA to guarantee approximately \$2.5 billion more in section 7(a) small business loans. OMB and SBA officials acknowledged that better oversight and improved internal controls at both OMB and SBA are needed to prevent similar errors in the future.

While no single agency yet is successful in all aspects of credit reform implementation, some progress is being made at each of the agencies we studied. The increasing audit attention on credit budgeting and accounting has focused efforts on improving subsidy estimation. Sustained greater commitment by agency management is needed to continue this progress and, to succeed, it is important that OMB continue to be a part of this effort.

Objectives, Scope, and Methodology

The objectives of our work were to determine (1) whether agencies completed estimates and reestimates of subsidy costs, (2) whether we could readily identify any trends including improvements in subsidy estimates as reported by the agencies, and (3) whether we could readily identify the causes for changes in subsidy estimates. You also asked us whether agencies with discretionary credit programs initially underestimated credit subsidy costs in response to the incentive created by the availability of permanent, indefinite budget authority for credit reestimates. We selected a sample of 10 programs from the five agencies with the largest domestic federal credit programs: the Departments of Agriculture, Education, Housing and Urban Development, and Veterans

¹³Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs (GAO/T-RCED-97-197, July 16, 1997).

Affairs, and the Small Business Administration. We generally selected programs that have the most credit outstanding or highest loan levels. Both direct loan and loan guarantee programs are represented. Table 1 in the following discussion of the availability of subsidy estimates and supporting documentation contains a list of the 10 programs we examined.

We requested that agencies provide budget data and information for the selected programs for fiscal years 1992 through 1998. The data requested included (1) descriptions of the credit program and highlights of program changes over the years, (2) spreadsheets showing estimated or reestimated cash flows of each cohort, (3) input to and output from OMB's credit subsidy model, and (4) documentation of agency efforts to revise the subsidy estimation process. For each cohort in fiscal years 1992 through 1998, we extracted the subsidy rate estimates used in the President's budget request, budget execution, and all reestimates. These data are included in appendix III.

Our work reports the subsidy rate data and documentation as provided by the agencies. We interviewed staff who prepared the subsidy estimates and obtained written confirmation from each agency that the data in the tables in appendix III were accurate and represented all of the data the agency had. However, we found problems with these data. While we did not independently verify the accuracy of these data, we did compare the budget request subsidy rates confirmed by the agencies to the rates reported in the appropriate Budget Appendix and Budget Credit Supplement. We found that agency-confirmed rates differed from the Budget in nine instances although only three differences were greater than half a percentage point.¹⁴ In two of these three instances, the agencies later provided documentation to support the rates in the Budget. In the third instance, we used the rate produced by the OMB subsidy model because the agency's cash flow spreadsheets best supported it. In addition, we reviewed recent financial statement audit reports for these credit agencies and programs as one gauge of the reliability of these data.

While we examined data for all 10 programs in the 5 credit agencies, specific examples used in our work discuss only those programs or agencies with comparable data. For example, we had comparable data from only seven programs to use in our analysis of the most recent subsidy estimates for the fiscal year 1992 and fiscal year 1998 cohorts. This is because all of VA's credit programs (including some not examined in this

¹⁴After conversations with agency staff about the other six instances where rates differed, we generally decided to use the rates provided by the agencies because documentation was available to support these rates.

report) were consolidated into two programs for fiscal year 1998 (a direct loan program and a loan guarantee program)¹⁵ and Education's direct loan program only began in fiscal year 1994.

We used the data in appendix III to try to identify trends in subsidy estimates. Appendix II includes graphs of total subsidy rates by cohort for nine programs and graphs profiling the subsidy rates of a given program cohort over time for eight programs. We did not prepare either graph for SBA's Disaster Loan Program because SBA had not included subsidy reestimates for any cohort in the President's Budget prior to fiscal year 1999. We also did not profile a cohort of USDA's Farm Operating Loans because we did not have enough comparable data for our review.

To further understand the causes for changes in subsidy rates, we then analyzed the four components of subsidy expense (interest, net defaults, fees and other collections, and other subsidy costs) required to be reported by SFFAS No. 2 and calculated by OMB's subsidy model. We also compared the budget execution estimate to the first reestimate for all credit programs and analyzed whether there was a different pattern in the direction of the reestimates for direct loan programs and loan guarantee programs or for mandatory and discretionary programs.

Our work was conducted in Washington, D.C., from September 1996 through January 1998 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the following officials or their designees: the Director of the Office of Management and Budget, the Secretary of Agriculture, the Secretary of Education, the Secretary of Housing and Urban Development, the Administrator of the Small Business Administration, and the Acting Secretary of Veterans Affairs. All of the entities provided written comments, which are discussed in the "Agency Comments and Our Evaluation" section and reprinted in appendixes IV through IX.

Problems Persist With Agencies' Estimates of Subsidy Cost

In each of the agencies in our study, we found problems with the availability of estimated subsidy rates and supporting documentation and with the reliability of the subsidy rate estimates. In 8 of the 10 programs we examined, agency staff either failed to do reestimates for certain years or completed them too late to be included in the budget formulation or audit cycles. While some progress has been made at some agencies, audits

¹⁵This consolidation of programs was authorized by the 1998 Department of Housing and Urban Development, Department of Veterans Affairs, and Related Agencies Appropriations Act.

of financial statements continue to show that serious problems remain. Effective implementation of credit reform is highly dependent on the availability of accurate data.

Subsidy Rate Estimates and Supporting Documentation Were Not Consistently Available

Agencies did not have for our review all of the estimated subsidy rates and supporting documentation for the seven budgets they prepared under credit reform for fiscal years 1992 through 1998. Also, the availability of subsidy rate estimates and reestimates generally did not improve over time. All nine programs¹⁶ in existence in 1992 when credit reform became effective had for our review budget request and budget execution subsidy estimates for the first 2 years under credit reform—fiscal years 1992 and 1993. The first reestimates of subsidy cost should have been done for the fiscal year 1994 Budget. Of the 10 programs we examined, 8 either failed to do reestimates for certain years or produced them too late to be included in budget formulation or audit cycles. Only five of the nine programs that should have completed reestimates for the fiscal years 1994 and 1995 Budgets had them for our review. Starting with the fiscal year 1997 Budget, OMB Circular A-11 provided that agencies could forgo completing reestimates under certain circumstances. For fiscal years 1997 and 1998, 5 of the 10 programs made timely reestimates. One of the programs, SBA's Disaster Loans Program, did not have subsidy reestimates in the Budget until the recently released fiscal year 1999 Budget. The programs that did not make reestimates generally reported staff constraints in completing reestimates while preparing their budget request or difficulties obtaining data on which to base reestimates. All reported that they had received waivers from OMB. We received written copies of OMB waivers to USDA and HUD permitting late completion of estimates. While USDA's waiver was effective for fiscal year 1996 and future budgets, HUD's waiver was only for fiscal year 1997. HUD staff told us that OMB gave them waivers orally for other years, and OMB did not disagree. SBA also told us that the waivers were approved by OMB orally, and OMB agreed.

On the other hand, for estimates and reestimates that were made, the availability of documentation has improved somewhat. In fiscal years 1996 through 1998, most programs did have documentation for estimates and reestimates that were made. Recent credit reform guidance explicitly

¹⁶The William D. Ford Direct Loan Program was established in fiscal year 1994.

requires agencies to document subsidy estimation.¹⁷ In the early years of credit reform, fiscal years 1992 through 1995, most programs did not have for our review supporting documentation for all completed budget estimates and reestimates. An official at Education characterized early credit program files as “woefully lacking.”¹⁸ HUD staff said that early credit estimates were prepared by OMB staff and that HUD and OMB do not have supporting documentation.

Table 1 shows, by program and fiscal year, whether agencies had for our review all subsidy estimates for the budget request and budget execution, made subsidy reestimates, and had supporting documentation for these estimates that we requested for our review. A check indicates that the agency had for our review all estimated rates, rates for reestimates they made, and had all supporting documentation contained in output from the OMB subsidy model and agency cash flow spreadsheets. It says nothing about the quality of the data. We discuss in some detail our concerns about data reliability later in this report.

¹⁷OMB Circular A-11 has required agencies to document how a credit program’s subsidy is calculated since the 1995 version issued as guidance for preparation of the fiscal year 1997 Budget. SFFAS No. 2 discusses using a systematic methodology and creating and maintaining a consistent database; it does not address documentation of the estimation process. An issue paper, *Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store* (96-CR-7, May 1, 1996), developed by the Government-wide Audited Financial Statements Task Force, Subgroup on Credit Reform, discusses reasonable methods of estimating subsidy rates and recommends using an auditable subsidy estimation procedure that formalizes and documents loan performance assumptions. It discusses the advantages of a documented model—greater availability for update, more conducive to review and comment, and more readily transferrable between analysts.

¹⁸Because we requested that agencies provide output from the OMB subsidy model and the underlying cash flow spreadsheets as documentation of their subsidy estimates, the two Education programs are shown in table 1 as having incomplete documentation in each year. Education uses the OMB subsidy model earlier in its estimation process than other agencies, adjusting the results to develop the subsidy rate used in the President’s Budget. Thus, Education’s OMB model output and cash flow spreadsheets do not support the rates included in the Budget. Further, Education did not provide alternate supporting documentation for those subsidy rates.

Table 1: Budget Request and Budget Execution Subsidy Estimates, Reestimates, and Supporting Documentation

Agency/Program (Loan type)	President's Budget for Fiscal Year						
	1992	1993	1994	1995	1996	1997	1998
USDA: Farm Service Agency, Farm Operating Loans Program (Direct)							
USDA: Rural Housing Service, Single Family Housing Program (Direct)		√		√			
Education: Federal Family Education Loan Program, Stafford Loans (Guarantee)							
Education: Wm. D. Ford Direct Loan Program, Stafford Loans (Direct)	^a	^a					
HUD: Mutual Mortgage Insurance Fund (Guarantee)							
HUD: Housing Program's General and Special Risk Insurance Fund Sect. 223(f) Refinance (Guarantee)							
SBA: 7(a) General Business Loans Program (Guarantee)		√				√	√
SBA: Disaster Loans Program (Direct)							
VA: Guaranty and Indemnity Fund (Guarantee)	√	√			√	√	√
VA: Loan Guaranty Direct Loan (Direct)	√	√				√	√

Note: √ indicates agencies that had for our review (1) all estimated budget request and budget execution subsidy rates and reestimated subsidy rates and (2) all supporting documentation from OMB's credit subsidy model and cash flow spreadsheets.

^aThe William D. Ford Direct Loan Program was established in fiscal year 1994.

Reliability of Some Subsidy Estimate Data Is Questionable

The reliability of credit data is questionable for a number of reasons including (1) the poor results of financial statement audits, (2) discrepancies we found between subsidy rates reported in the President's Budget and the data confirmed to us by the agencies, (3) subsidy rate estimates not always supported by documentation, (4) acknowledgements from some staff that component data were questionable, and (5) staff reports of difficulties with systems support. First, financial statement audits raised questions about data reliability.

Three of the largest credit agencies, HUD, USDA, and Education, received disclaimers or qualified opinions¹⁹ on their fiscal year 1996 financial statement audits, in part, because of problems associated with their credit programs. HUD received a qualified opinion because the Federal Housing Administration's (FHA) credit-related accounts were not reported on the present value basis required by SFFAS No. 2.²⁰ Consequently, HUD's Office of the Inspector General (OIG) was unable to audit the credit-related account balances. USDA's OIG gave a qualified audit opinion on the fiscal year 1996 financial statements of the rural development mission area because it was unable to obtain sufficient support for credit program receivables and estimated losses on loan guarantees and the related credit reform program subsidy and appropriated capital used. USDA's Farm Service Agency Farm Operating Loans were included as part of the consolidated audit of USDA's fiscal year 1996 financial statements which received a disclaimer of opinion. The Farm Service Agency does not prepare separate financial statements. Education received a disclaimer of opinion on the department's fiscal year 1996 financial statements because it was unable to support the reasonableness of the amounts shown for loans receivable and liabilities for loan guarantees. Education's OIG also was unable to render an audit opinion due to auditor concerns about the quality of the data supporting subsidy estimates of the Federal Family Education Loan Program. This could reflect problems with historical data since agencies with loan guarantee programs rely on lenders or intermediaries for loan performance data. In some cases, the auditors recommended that agencies establish and document a process for the development of subsidy estimates and make reestimation of subsidy costs a priority.

Although VA and SBA both received unqualified audit opinions on their fiscal year 1996 financial statements, the auditors of these agencies reported internal control weaknesses related to estimating credit subsidies. For example, SBA's auditors reported that the agency used

¹⁹A disclaimer of opinion on financial statements is issued whenever auditors are unable to satisfy themselves that the overall financial statements are fairly presented. A disclaimer may arise because of a severe limitation in the scope of the audit, perhaps due to a lack of documentation and/or uncertainties about the amount of an item or outcome of a matter that materially affects financial position. A qualified opinion on financial statements can be used only when the auditor believes that the overall financial statements are fairly stated other than with regard to the noted qualification. The qualification may result from a limitation on the scope of the audit, failure to follow generally accepted accounting principles, use of different accounting principles during one of the years included in the statements, or circumstances that prevented the auditor from knowing that the statements were fairly presented.

²⁰Because FHA is a government corporation, it reports costs in its financial statements in accordance with private sector accounting standards. However, because FHA's financial results are material to HUD's financial statements, it should comply with SFFAS No. 2 when it is included in HUD's consolidated financial statements. By not complying with credit reform's accounting standards, HUD is not accurately reporting the costs of its programs in its financial statements.

inconsistent and unreliable data to reestimate the Disaster Loan Program. Because of the questionable data, OMB and SBA had not included any reestimate of this program until the fiscal year 1999 Budget or the fiscal year 1997 financial statements. In addition, VA's auditors reported that the agency does not efficiently and reliably accumulate the financial information needed to comply with credit reform accounting requirements and that significant credit reform-related adjustments were necessary to the financial statements.

Second, we found discrepancies between the subsidy rates reported in the President's Budget and the data provided and confirmed to us by the agencies²¹ in about 10 percent of our sample (7 of 68 rates). Some agencies agreed, after we pointed out inconsistencies, that certain data they had provided and certified as accurate in fact were not. Third, agencies also had for our review subsidy rate estimates that were not always supported by the documentation. For example, none of Education's documentation supported its estimated subsidy rates. Also, agencies, such as HUD, had difficulty identifying the fiscal year of available subsidy rates and documentation and whether the rates were budget execution estimates or reestimates. Fourth, staff from seven of the eight programs whose component data we were able to examine acknowledged that the data were questionable. We found that component data were questionable because they were not consistent with program characteristics. For example, VA's direct loan program showed the net default component as negative because cash flows from loan sales were included with recoveries from defaulted loans. As a result, recoveries exceeded defaults. To avoid erroneously indicating that higher defaults would reduce the subsidy rate, proceeds from loan sales should have been included with the "other cash flow" component.

Fifth, and finally, data reliability depends in part on having adequate information systems, and effective top management commitment is vital to ensuring that these are provided. Today, as 4 years ago, staff in most agencies we examined report difficulties with systems support. For example, staff in three of the five agencies we reviewed—HUD, VA, and USDA—reported inadequate actual data on loan performance and computer systems support. These agencies have efforts underway to refine their data and/or improve their estimation processes. Staff at USDA and VA have worked with their offices of the inspector general or OMB to refine their cash flow spreadsheets and reestimate calculations. HUD staff reported

²¹Although it is unclear without further investigation which rates were accurate, we generally included in appendix III tables those rates provided by the agencies because they were supported by some documentation.

efforts underway to develop a new integrated accounting system and a need to re-engineer budget and accounting processes.

Staff in the other two agencies—Education and SBA—told us that systems support was not an issue and reported that credit reform implementation has become a high-level priority for their agencies. Specifically, SBA administrators had a commitment to meet the requirements of the Federal Credit Reform Act and sought to improve their capacity to make better subsidy cost estimates. Both agencies reported that they had developed new computer systems, significantly refined their historical information stores, and are using contractor support. Although upper-management commitment is necessary, it does not result in instant improvement. Audits continue to report problems at both agencies, both have difficulty obtaining historical information, and SBA and others have identified errors in SBA subsidy estimates.

OMB and credit agency staff acknowledge that budget and financial systems for credit programs could have problems with conversions to the year 2000.²² In a February 1998 report on agencies' progress in addressing Year 2000 conversion, OMB reported that SBA and VA were demonstrating sufficient progress, USDA and HUD were making some progress but OMB still had concerns, and Education was making insufficient progress. In testimony in September 1997,²³ we reported that the Veterans Benefits Administration, where its housing credit programs are located, has developed an agencywide plan and created a program management organization but will need to strengthen management and oversight of Year 2000-related activities to avert serious disruption of its ability to disseminate benefits. Since our testimony, VA has taken action to address some of our concerns.

Subsidy Rates Generally Fluctuated

Over time, some fluctuation in subsidy rates would be expected within a given group of loans or guarantees (a cohort) and among different cohorts of the same program. Reasons include loans or guarantees made at different interest rates than anticipated; programmatic redesign; better

²²On January 1, 2000, computer systems worldwide could malfunction or produce inaccurate information simply because the date has changed. Unless corrected, such failures could have a costly, widespread impact. The problem is rooted in how dates are recorded and computed. For the past several decades, systems have typically used two digits to represent the year—such as “97” for 1997—to save electronic storage space and reduce operating costs. In such a format, however, 2000 is indistinguishable from 1900. This ambiguity could cause systems to malfunction in unforeseen ways or to fail completely.

²³Veterans Affairs Computer Systems: Action Underway Yet Much Work Remains To Resolve Year 2000 Crisis ([GAO/T-AIMD-97-174](#), September 25, 1997).

information on technical factors such as defaults, prepayments, and fees from more actual experience; or unanticipated changes in the economy including interest rate changes. Agencies have had several years to obtain and refine historical data and estimation methodologies. Over time we would expect to find that, for a given cohort, the annual changes in reestimates due to technical factors would be smaller. We believe that agencies can improve their abilities to forecast such factors as defaults, recoveries, prepayments, and fee revenue through better modeling and more and better historical data. As this improvement occurs, the variability in the subsidy rate from year to year for a given cohort caused by these factors (as opposed to economic factors such as interest) should diminish. Because reliable component data were not available, we could not readily determine whether this had occurred. However, total subsidy estimates within a given cohort often varied widely over time. Moreover, estimates for different cohorts within the same program also differed widely. These sharp variations raise questions about the causes for these changes and the reliability of the underlying data. The success of credit reform budgeting relies on reasonable estimates informed by timely, appropriate actual data.

We analyzed the data from several perspectives:

- Comparing Estimated Subsidy Rates Over Time For a Given Cohort—In the programs we examined, we found that reestimates often were large and changed direction over time—increasing or decreasing estimated subsidy cost. During the period of time between a given cohort's budget execution estimate and its most recent reestimate, we found that reestimates generally fluctuated both up and down. A total of 74 percent of the 23 cohorts we analyzed²⁴ had at least one reestimate increasing the subsidy rate and at least one reestimate that decreased the subsidy rate. For example, estimates and reestimates of the fiscal year 1992 cohort of Education's FFELP program changed direction each of the 6 years of data, estimated subsidy rates ranged from 26.30 percent to 16.99 percent. This could result from any number of factors, including changes in assumptions about cash flows as agencies gained experience in estimating subsidy rates or developed better actual loan data, and changes in the timing of loan activity or interest rates. Only VA's Loan Guaranty Direct Loan Financing Account did not have both increases and decreases in its subsidy estimate, as shown in figure II.17. Graphs of selected cohorts are included in appendix II. Viewed another way, we compared two specific subsidy rate

²⁴We examined only cohorts for which we had at least three reestimates or budget execution estimates and two reestimates.

estimates—budget execution and the first reestimate—in eight programs for which we had appropriate data (27 cohorts). We found that the first reestimates of the subsidy rates were higher than the budget execution rates for 13 cohorts and were lower for 14 cohorts. We also found that 15 of the 27 cohorts had changes of at least 20 percent—7 increases and 8 decreases. One cohort in the SBA 7(a) program increased by 126 percent.

- Comparing Estimated Subsidy Rates for Different Cohorts of a Given Program—We also analyzed the estimated subsidy rates for a given program by comparing the most recent estimates or reestimates for different cohorts. For example, as shown in figure II.16, the subsidy estimates and reestimates of the fiscal years 1992 through 1997 cohorts in VA's Loan Guaranty Direct Loan Financing Account²⁵ changed direction in each of the 6 years of data, and estimated subsidy rates ranged from 4.80 percent to 1.18 percent. We found that the fiscal year 1998 President's Budget showed that six of eight programs had a lower estimated subsidy rate for their new fiscal year 1998 credit than they reestimated for their fiscal year 1992 credit, the oldest cohorts in our study. Only HUD's Federal Housing Administration's Mutual Mortgage Insurance Fund and VA's Loan Guaranty Direct Loan Financing Account had estimated subsidy rates for fiscal year 1998 credit that were higher than the reestimates of the fiscal year 1992 cohort. This relatively consistent pattern of lower estimated subsidy rates in fiscal year 1998 may reflect changes in economic conditions such as lower interest rates, data errors, and/or changes by agencies designed to lower the subsidy cost such as increasing fees, reducing the share of the loan receiving the government guarantee, and improving debt collection. To determine the cause of specific subsidy rate differences would require examining the detailed assumptions used to estimate a program's cash flows over the full term of the credit. Graphs of the most recently estimated subsidy rates for all cohorts in 9 of the 10 programs in our sample are included in appendix II. SBA's Disaster Loan Program is not included because the agency had not reestimated the program's subsidy costs at the time of our review.

²⁵These estimates and reestimates were completed for the fiscal year 1997 President's Budget.

- Comparison of Estimated Subsidy Rates for Direct Loans to Those for Loan Guarantees—Loan type was not a predictor of whether subsidy rates increased or decreased from the budget execution rate to the first reestimate.²⁶ For example, of the three direct loan programs and five loan guarantee programs for which we had appropriate data, only one program—VA’s Guaranty and Indemnity Fund guarantee program—did not have at least one cohort with an upward reestimate and at least one cohort with a downward reestimate.

Available Data Not Sufficient to Assess Whether Budgetary Treatment Affected Initial Subsidy Estimates

To obtain some insight on the potential effect of credit reform’s automatic appropriation (unconstrained by discretionary spending limits) for reestimates, we compared the budget execution estimate to the first reestimate²⁷ for mandatory programs and for discretionary programs. As explained previously, initial appropriations for discretionary programs must compete with other programs for the specified amount of funding available under the discretionary spending limits set in law. Mandatory credit programs are automatically funded for whatever amount of credit is needed for a given program design and set of program beneficiaries. Both discretionary and mandatory credit programs automatically receive funding for the cost of reestimates without regard to Budget Enforcement Act limits. Thus, agencies with discretionary credit programs could benefit from initially underestimating subsidy rates. If the pattern in the direction of reestimates for discretionary and mandatory programs were the same, it would be an indication that this provision of law was not affecting original estimates. It may be difficult to determine whether agencies intentionally underestimated subsidy costs in initial estimates given data unreliability and the number of other factors (such as changes in interest rates or other economic conditions) that could affect subsidy estimates and reestimates.

We do know of one instance in which the issue was raised. SBA, an agency with discretionary credit programs, hired Price Waterhouse to conduct a diagnostic review of SBA’s existing internal controls. This September 1997 study said that “the credit subsidy process is not viewed as a way of assessing the future risk and costs of the program for management purposes. Rather, the rate calculation is perceived [by SBA] to be a tool for

²⁶This analysis is independent of whether the credit program is treated as discretionary or mandatory in the budget.

²⁷The first reestimates of subsidy rates are important because they are the first opportunity for agencies to revise subsidy estimates used in budget execution and receive permanent, indefinite budget authority for any increase. HUD’s Mutual Mortgage Insurance (MMI) program has an option to use a different budgetary treatment specified in its authorizing legislation. As a policy decision with OMB, MMI uses liquidating account reserves as envisioned in its authorizing legislation, not the permanent, indefinite budget authority available under credit reform. See our earlier report ([GAO/AIMD-94-58](#), September 26, 1994) for a more detailed discussion of this issue.

gaming the congressional appropriations process.” In commenting on a draft of this report, SBA officials disagreed with this conclusion. SBA officials stated that the Price Waterhouse report was incorrect and, due to its special nature, it was not corrected. In support of their position, SBA officials cited the quality of their data and staff and SBA’s commitment to have accurate and credible subsidy rates. However, we found, as discussed earlier, an error in SBA’s subsidy estimation methodology and that their component data were not always correct. Also, when we discussed SBA’s concerns with a Price Waterhouse staff member, he stated that its report was accurate for the period it covered, spring 1997. He described its report as based on interviews and a review of documentation.

The available data we were able to obtain were not sufficient to assess whether a credit program’s budgetary treatment affected its initial subsidy estimates. We found somewhat similar patterns when we compared discretionary and mandatory programs. We found that the estimated subsidy rates for 8 of the 15 discretionary cohorts increased in the first reestimate following the initial appropriation, while first reestimates for 7 of the 12 mandatory cohorts decreased.

This result is not conclusive. No real conclusions can be drawn from this observation about whether some discretionary programs may have sought to benefit from initially underestimating subsidy costs. Any firm conclusion about the reasons for reestimates would require better data and more in-depth study. Other factors, such as changes in the economy—including interest rates—or more historical data, may have contributed to these reestimates. Further, as audits have demonstrated, much of the data are not reliable. Also, sensitivity analyses and other sources showing the key variables that affect subsidy rates were not consistently available.

Lack of Reliable Component Data Hampers Ability to Determine the Causes of Changes in Subsidy Estimates

Data on the four components of subsidy expense—interest costs, net defaults, fees and other collections, and other subsidy costs—could be used to examine the causes for changes in subsidy rate estimates. Ideally, these data, calculated by the OMB subsidy model as part of the subsidy estimation process, would provide a ready basis to analyze such changes and thus identify possible policy responses. However, these component data were frequently missing or inaccurate, and thus we were unable to use them for identifying causes of changes in estimates.

SFFAS No. 2 provides general definitions of these components and requires agencies to disclose them in financial statements. The Federal Accounting Standards Advisory Board commented on the importance of such data stating that “the cost component information would be valuable for making credit policy decisions, monitoring portfolio quality, and improving credit performance. Information on interest subsidies and fees would help in making decisions on setting interest rates and fee levels. Information on default costs would help in evaluating credit performance.” It also could be useful as a performance measure to comply with the Government Performance and Results Act. With better data, decisionmakers could compare these components across programs and agencies to see the effect of programmatic differences.

The potential usefulness of the component data was recently demonstrated by our analysis of SBA component data. Although SBA’s subsidy component data were flawed, they still provided a quick indication to GAO that there was an error in the fiscal year 1997 subsidy estimates for the section 7(a) General Business Loan Program.²⁸ Correcting this error enabled SBA to guarantee approximately \$2.5 billion more in section 7(a) small business loans.²⁹ OMB and SBA officials acknowledged that better oversight and improved internal controls at both OMB and SBA are needed to prevent similar errors in the future.

A model developed by OMB staff to calculate credit subsidies aggregates detailed data on defaults, recoveries, prepayments, and other cash flows to calculate the components of subsidy expense on a present-value basis. In describing the OMB credit subsidy model, OMB guidance to agencies says “use of a common subsidy model ensures comparability and uniformity among all Federal credit program subsidy estimates.”³⁰ However, VA, USDA, SBA, and HUD did not distribute their cash flows consistently among the components. OMB Circulars A-11 and A-34 did not provide definitions of the subsidy components. The user’s guide for OMB’s subsidy model did not provide sufficiently clear definitions of the components to ensure that the components could be calculated accurately. Agency staff said they did not have a clear understanding of the definitions and thus were unsure about where the OMB model allocated detailed data for each of their program’s cash flows in calculating the subsidy expense components. Agency staff

²⁸Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs (GAO/T-RCED-97-197, July 15, 1997).

²⁹Had the actual subsidy rate been known in advance, the Congress could have chosen whether to provide the same amount of budget authority for a higher loan amount or to hold the loan amount constant and provide less budget authority.

³⁰OMB Circular A-34, section 12.7 (December 1995).

were unclear about what the data produced by the model represented. In an earlier report reviewing the credit subsidy model,³¹ we recommended that OMB revise the model to specifically identify which data were used by the model in the subsidy calculations.

Further, OMB did not require agencies to use the subsidy model at a specific point in their estimation process as they are developing subsidy estimates for their budget submissions. Education officials noted that, with the participation and approval of OMB, Education uses the model as an interim step in subsidy estimation, not at the end as do other agencies. Education uses a methodology that makes minor adjustments to subsidy rates produced by the model. As a result, Education staff did not provide component data for its reestimated subsidy rates.

Clear definitions of each subsidy component and specific OMB instructions and assistance to agencies in using its subsidy model could provide better assurance of accurate and comparable component data. Since our inquiries, staff at VA, USDA's Rural Housing Service (RHS), and HUD worked with OMB staff to clarify requirements and address problems with component data.

Further, staff from five of eight programs whose component data we were able to examine acknowledged that the data were questionable. We found that component data were inaccurate because they were not consistent with program characteristics. RHS staff said that, before fiscal year 1996, the component data were incorrect because they adjusted underlying data in using early versions of the OMB subsidy model that did not accommodate their program characteristics. As discussed earlier, VA's direct loan program showed the net default component as negative in each of the 7 years that data were available. This erroneously indicates that higher defaults would reduce the subsidy rate. Component data provided by the agencies are shown in the tables in appendix III.

This potentially useful information was not understood by agencies, often was unavailable, sometimes was not accurate, and thus was not used to inform program management or budget decision-making. In a letter responding to a recent GAO report on OMB's subsidy model, OMB acknowledged that it would be useful for the revised subsidy model to have a facility to display, at the option of the user, the calculation of subsidy percentages and components.

³¹Credit Reform: Review of OMB's Credit Subsidy Model (GAO/AIMD-97-145, August 29, 1997).

Improvements Underway

There have been a number of recent efforts to clarify and simplify implementation of the Credit Reform Act. The Balanced Budget Act of 1997 included some changes to the Credit Reform Act and OMB has changed its guidance as well. OMB is piloting a new reestimation methodology—called the “balances approach”—at HUD that it states will simplify the process. However, this new approach does not calculate the components of subsidy expense (interest, net defaults, fees and other collections, and other subsidy costs) over the entire term of the loans as does the current reestimate methodology. The data from which to calculate components would remain available with the balances approach, but what is lost is having the component data calculated as a part of the reestimate process. Further, if there is no requirement to report or review the data in that way, agencies would have less incentive than now to make the calculations and use the data. OMB also is formulating a new approach to discounting cash flows that it states will improve accuracy without adding difficulty for agency staff.

The Credit Task Force of the Accounting and Auditing Policy Committee,³² which includes OMB, Treasury, credit agency participants, and GAO, has been studying credit reform implementation in preparation for the first audit of the fiscal year 1997 governmentwide consolidated financial statements. The group has proposed guidance for agencies on methods and documentation for estimating subsidy rates and creating a store of historical data.³³ It also developed draft guidance³⁴ on preparing and auditing subsidy estimates that will be useful for budget, accounting, and auditing staff. The Credit Reform Committee of the Chief Financial Officers' Council also has devised ways agencies can simplify implementation of credit reform.

Other resources are available to help agencies enhance their capacities to make subsidy estimates. For example, OMB has provided short-term technical assistance with estimation and modeling to VA, SBA, and HUD. As those efforts continue, staff in agencies who report that they lack adequate resources for research or systems development could adapt strategies or data system formats that have been used successfully in other agencies.

³²This task force formerly was known as the Subgroup on Credit Reform of the Government-wide Audited Financial Statements Task Force.

³³Government-wide Audited Financial Statements Task Force, Subgroup on Credit Reform, Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store (96-CR-7, May 1, 1996).

³⁴Government-wide Audited Financial Statements Task Force, Subgroup on Credit Reform, Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act (96-CR-14, October 16, 1997).

However, management-level commitment at all of the credit agencies and OMB is critical to continuing these efforts and to ensuring that the implementation of credit reform is an agency priority.

Conclusions

Greater sustained commitment by management at OMB and the credit agencies is needed to produce the useful data needed to fully implement credit reform. Effective implementation requires timely, readily available, accurate estimates that are comparable among credit programs. Although there are indications that some agencies have taken this seriously, problems with the availability and reliability of subsidy estimates continue to permeate all agencies' efforts at implementation. While agencies are working to improve their subsidy estimation processes, agency staff continue to report that credit reform implementation often is not a priority of top management. This is indicated both by the failure to ask questions about estimates in program and budget reviews and by the reported lack of sufficient computer systems to support the subsidy estimation process. Greater commitment by OMB and the credit agencies is needed to address pervasive problems with the availability and reliability of subsidy estimate data and documentation. Since agencies are most responsive to issues in which there is demonstrated interest, continued oversight would increase the likelihood that credit reform would be implemented as intended. Better and more reliable data are needed to facilitate this oversight.

The availability of automatic funding for reestimates of subsidy costs creates an incentive for agencies with discretionary programs to initially underestimate subsidy costs. Whether or not agencies are responding to this incentive is unclear. Because the data generally are not reliable and because other factors, such as economic fluctuations (including changes in the interest rate) could have caused changes in reestimates, more in-depth study and better data would be needed to draw a firm conclusion.

Accurate, consistent data on subsidy expense components could be used effectively by program managers and executive and congressional decisionmakers as originally intended—to monitor program implementation, consider program changes, and compare direct loan and loan guarantee programs designed for the same purpose. Currently, data are inaccurate or missing and agency staff said they do not understand the data. Therefore, component data have not been available to inform decision-making.

While no single agency yet is successful in all aspects of credit reform implementation, some progress is being made at each of the agencies we studied. Over time, the scrutiny of financial statement audits will continue to bring greater discipline to the estimation process and greater accuracy to the reported subsidy costs.

Recommendations

We recommend that the Secretaries of Agriculture, Education, Housing and Urban Development, and Veterans Affairs, and the Administrator of Small Business improve oversight of credit reform implementation, including ensuring that (1) estimates are prepared accurately and (2) documentation supporting subsidy estimates included in the budget and financial statements is prepared and retained.

So that agency staff can aggregate data from their cash flows into the OMB subsidy model accurately and consistently, we recommend that the OMB Director ensure that OMB staff (1) provide detailed guidance and definitions of the four subsidy components (interest, net defaults, fees and other collections, and other subsidy costs) and (2) revise the OMB subsidy model to provide agencies with the formula for calculating each component. We also recommend that the OMB Director ensure, to the extent possible, that agencies prepare accurate subsidy estimates, use consistent definitions of subsidy components, and have appropriate documentation.

Finally, we recommend that the OMB Director work toward identifying ways OMB can further assist agencies to more rapidly and accurately implement credit reform. These might include providing additional direct assistance to the agencies, developing prototypes for estimating methodologies, and prompting interagency forums for the exchange of information on problems and best practice solutions by working level staffs.

Agency Comments and Our Evaluation

OMB and each of the five credit agencies we examined commented on a range of implementation problems and progress. OMB officials commented that the report's focus on subsidy estimation is valuable. However, OMB officials stated that our analytical methodology was questionable because the report did not distinguish between the effect of interest rates on initial subsidy rates and the effect of default and other technical factors. Our methodology was designed to isolate the effects of interest rates by using component data and budget execution rates. It is true that interest rates

would change each year even if the default and other technical assumptions remain constant. Unfortunately, we could not isolate these effects because agencies frequently did not provide these data or provided inaccurate data. We used budget execution rates as the starting point for our analyses. This reduced the effect of interest rate changes in the months between budget request and budget execution.

OMB also stated that several of the report's general conclusions about subsidy estimates were not supported by the evidence. We disagree. First, OMB officials noted that unless an adjustment is made for the effect of different discount rates, it is impossible to draw valid conclusions about the accuracy of subsidy rates by observing that they have fluctuated over time. We did not draw conclusions about the accuracy of subsidy rates. However, we did observe that the rates fluctuated over time and that some fluctuation would be expected. We said in the report that the reliability of credit data is questionable for a number of reasons. Our characterization of the data was based primarily on results of the audits of the fiscal year 1996 financial statements as well as some discrepancies we identified between rates provided to us by agencies and those reported in the President's Budget. Second, OMB officials said that we could not draw conclusions about a program from the size or direction of subsidy reestimates unless the effect of interest rate reestimates is removed. Our report did not draw conclusions about programs from the size or direction of subsidy reestimates. Third, OMB officials were concerned that our discussion of the timing of reestimates could lead to the incorrect conclusion that the budget formulation process for subsidy rates for new loans is not being informed by the experience on existing loan cohorts. We disagree. Such a conclusion regarding the effect of not performing reestimates is, in fact, correct. Given that we found three of the five agencies received waivers of the reestimate requirement, it would appear that their budget formulation is not being informed by the most recent experience on existing loan cohorts. (See appendix IV.)

Agriculture officials stated that the report's comments and suggestions will improve budget formulation and accounting for programs under credit reform. They further stated that FSA is working to address the concerns noted in the report. (See appendix V.)

Education officials strongly agreed with the report's emphasis on the importance of the Federal Credit Reform Act of 1990. Their comments note that, over the past 5 years, Education has steadily increased staff, contractor, and system resources dedicated to developing accurate and

timely credit estimates. Education officials also raised a question about their perception that our report implied that “significant shifts in subsidy reestimates over time are necessarily a bad thing.” Our report did not imply this. Rather, we said that over time, some fluctuation in subsidy rates would be expected, some estimates varied widely, and these sharp variations raise questions about the causes for these changes and the reliability of the underlying data. Education officials also provided some clarification of their use of the OMB subsidy model. (See appendix VI.)

HUD officials acknowledged that the agency has experienced some reporting and estimation problems and stated that the agency has made significant progress since the enactment of the Federal Credit Reform Act of 1990. They noted that the draft report documents the difficulty that virtually every agency is experiencing in dealing with credit reform requirements. HUD officials stated that the problem with cost estimates has less to do with the level of effort devoted to data collection and the timeliness of reestimation than it has to do with inherent limitations of the net present value technique in cost estimation. We agree that credit reform has been a challenge to agencies. However, cash basis reporting for credit programs, while easier to accomplish, does not reflect their costs. When sufficient attention is devoted to net present value estimates of costs as required under the Federal Credit Reform Act, these subsidy costs will be a much better basis for budgeting. (See appendix VII.)

SBA officials’ expressed concern that we quoted a Price Waterhouse report prepared at SBA’s request. SBA officials stated that the Price Waterhouse report was incorrect and, due to its special nature, was not corrected. In support of their position, SBA officials cited the quality of their data and staff and SBA’s commitment to have accurate and credible subsidy rates. However, as discussed earlier, we found an error in SBA’s subsidy estimation methodology and that their component data were not always correct. Also, when we discussed SBA’s concerns with a Price Waterhouse staff member, he stated that its report is accurate for the period it covered, spring 1997, and was based on interviews and a review of documentation.

SBA officials said their practices represent the leading edge of compliance with the Federal Credit Reform Act and requested that we acknowledge this if we agreed. Our report recognized that some progress in implementation is being made at each of the agencies we studied, and we specifically acknowledged SBA’s commitment and efforts to improve. (See appendix VIII.)

VA officials agreed with the report's recommendations and provided their insights regarding the complexities of credit estimation and its evolution over the years at VA. They also provided some technical comments, which we have addressed as appropriate. (See appendix IX.)

We are sending copies of this report to the Ranking Minority Member of the Senate Committee on the Budget; the Chairman and Ranking Minority Member of the House Committee on the Budget; the Director, Office of Management and Budget; the Director, Congressional Budget Office; the Secretaries of Agriculture, Education, and Housing and Urban Development, and the Acting Secretary of Veterans Affairs; the Administrator of Small Business; and interested congressional committees. Copies also will be made available to others upon request.

This report was prepared under the direction of Christine Bonham, Assistant Director, Budget Issues, who may be reached at (202) 512-9576. Other major contributors to this report are listed in appendix X. Please contact me at (202) 512-9142 if you or your staff have any questions concerning the report.

Sincerely yours,

A handwritten signature in black ink that reads "Susan J. Irving". The signature is written in a cursive, flowing style.

Susan J. Irving
Associate Director, Budget Issues

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Abbreviations

CBO	Congressional Budget Office
CFO	Chief Financial Officer
FASAB	Federal Accounting Standards Advisory Board
FFELP	Federal Family Education Loan Program
FHA	Federal Housing Administration
FSA	Farm Service Agency
HUD	Department of Housing and Urban Development
MMI	Mutual Mortgage Insurance
OIG	Office of the Inspector General
OMB	Office of Management and Budget
RHS	Rural Housing Service
SBA	Small Business Administration
SFFAS	Statement of Federal Financial Accounting Standards
USDA	Department of Agriculture
VA	Department of Veterans Affairs
VBA	Veterans Benefits Administration

Background: Credit Reform

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 1996, the face value of the government's direct loans and loan guarantees totaled a reported \$973 billion, of which \$167 billion was in direct loans and \$806 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 Federal 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 a credit program over its entire life 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 effect of a direct loan disbursement could be much less than a noncredit budget transaction of the same dollar amount. The change in economic behavior resulting from loan guarantees occurred when the loan was made, not when the government's cost was included in the federal budget. Thus, for both direct loans and loan guarantees the budget did not reflect the change in economic behavior.

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.

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 first may be 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 regardless of the actual cost to the government.

Loan guarantees appeared to be free in the short run while direct loans initially appeared to be as expensive as grants because the budget did not recognize that at least some of the guaranteed loans would default and that some of the direct loans would 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. 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 the program was likely to entail future losses. Budget authority and outlays were recorded only when 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 non-credit 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 Federal 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, other recoveries, and other payments). In making these calculations, agencies must include the cost to the federal government of borrowing the funds. The act 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).

Agencies prepare these cost estimates on a net present value basis as a part of their budget request. For the budget years we reviewed, agencies then recalculated the subsidy rate when they extended credit by updating the approved rate for any changes in interest rates and legislation. They make direct loans and loan guarantee commitments as possible under this appropriation. Later, after the end of the fiscal year, agencies reestimate subsidy costs based on actual experience and expected economic changes.

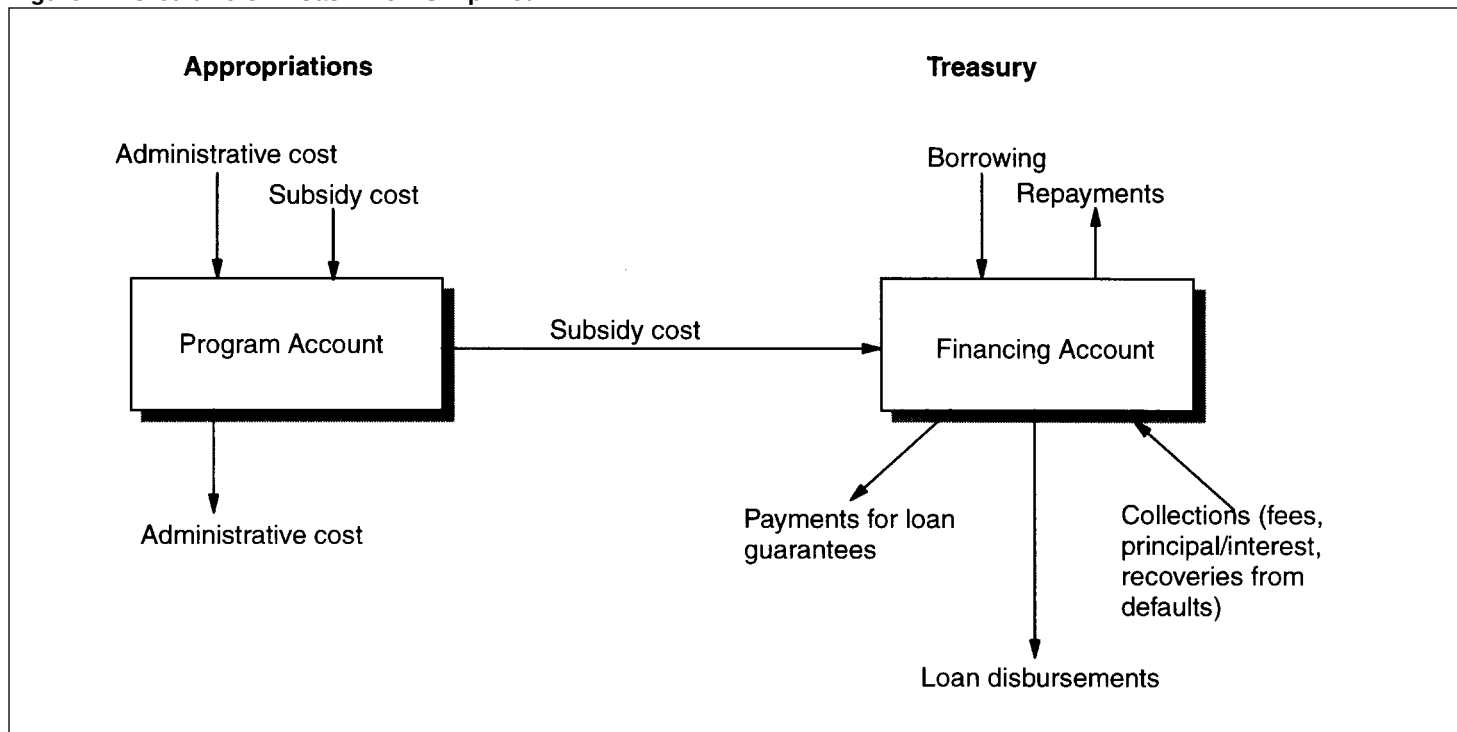
Credit Programs Now Use Three Budgetary Accounts

The Federal 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,¹ 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



¹Nonbudgetary 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.

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

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 authority² to cover any losses. Excess balances are transferred periodically—at least annually—to the Treasury.

In addition to the three accounts specified in the Federal Credit Reform Act, OMB has directed that discretionary credit programs or activities with negative subsidies must have special fund receipt accounts. These accounts hold receipts generated when the program or activity shows a profit or when a downward reestimate of subsidy costs indicates that the financing account balance is too high. OMB guidance provides that discretionary programs cannot use these receipts unless they are appropriated, while mandatory programs may use the receipts without appropriation action.

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-129.³ OMB also has issued memorandums to provide additional implementation guidance addressing specific situations. Treasury's guidance is provided in materials such as Basic Transactions Relating to Guaranteed Loans and Subsidies, 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. Accounting guidance, consistent with the intent of the Federal Credit Reform Act, is found in Accounting for Direct Loans and Loan Guarantees, Statement of Recommended Accounting Standards, Number 2. This guidance was developed by the Federal Accounting Standards Advisory Board (FASAB) and approved in July 1993, by OMB, the Department of the Treasury, and GAO.

²Permanent 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.

³OMB Circular A-11, Preparation and Submission of Budget Estimates; OMB Circular A-34, Instructions on Budget Execution; and OMB Circular A-129, Managing Federal Credit Programs.

Implementation Guidance Has Changed

Fiscal year 1998 is the seventh year that credit programs have been required to comply with credit reform. 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 Federal Credit Reform Act does not provide explicit direction. OMB and Treasury have refined their guidance to agencies based on greater experience with the processes and data requirements for implementing credit reform and on more information on agencies' limitations and abilities.

The Balanced Budget Act of 1997 amended the Federal Credit Reform Act to clarify and simplify the requirements for subsidy cost estimation. Among other changes, the Federal Credit Reform Act was amended to require agencies to make loans and guarantees using the technical assumptions such as default, recoveries, and fees included in the President's Budget for the year in which funds are obligated. As a result, the dollar amount of loans approved by the Congress will not be increased or decreased by subsequent changes to technical assumptions. The act also was amended to require agencies to return to the Treasury any excess funds in accounts for pre-1992 credit, and to change budgetary treatment of credit from the Federal Financing Bank.

At the same time, OMB has drafted revised guidance to credit agencies. The changes include eliminating the requirement to reestimate annually the change in subsidy cost due to changes in interest rates as disbursements are made for a cohort's loans and loan guarantees. Instead, agencies are required to do only one interest rate reestimate when the cohort is 90 percent disbursed. Interest rate reestimates before a cohort is fully disbursed are of questionable validity since the discount rate will continue to change. The reestimates thereby cause large swings in subsidy estimates with no value added to management decision-making or the reliability of budgetary or financial reporting. OMB also has developed an alternative, simplified method for agencies to calculate reestimates—called the "balances approach." This new approach, which is being tested at HUD, looks forward, projecting and discounting remaining cash flows from a cohort and comparing them to the current balance owed to Treasury. The method used to date looks both backward and forward, requiring agencies to revise estimates of all cash flows for a cohort—those that already have occurred and those in the future. However, this new approach does not calculate the components of subsidy expense (interest, net defaults, fees and other collections, and other subsidy costs) for the entire term of the loans as does the current methodology. The data from

which to calculate components would remain available with the balances approach, but what is lost is having the component data calculated as a part of the reestimate process. Further, if there is no requirement to report or review the data in that way, agencies would have less incentive than now to make the calculations and use the data.

Several interagency groups also reviewing agencies' implementation and the current requirements of credit reform have made recommendations that have been adopted or endorsed by OMB and Treasury. The Credit Reform Committee of the Chief Financial Officers Council has recommended certain actions that would simplify budget execution and accounting. The Credit Task Force of the Accounting and Auditing Policy Committee (formerly the Credit Subgroup of the Government-wide Audited Financial Statements Task Force) has issued three papers. The first outlines an ideal model for estimating and documenting subsidy rates.⁴ The paper recognizes that credit agencies are many years away from being able to implement such a method, but discusses reasonable methods for subsidy rate estimation and discusses the types of actual loan data that might be maintained to support agency subsidy estimates. The second paper provides draft guidance for agencies' budget and accounting staff and auditors for preparing and auditing direct loan and loan guarantee subsidy estimates.⁵ The third paper outlines recommended changes in the accounting standards for direct loans and loan guarantees and interpretations of the standards on the display of the components of subsidy expense.⁶

⁴Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store, Government-wide Audited Financial Statements Task Force, Subgroup on Credit Reform (96-CR-7, May 1, 1996).

⁵Preparing and Auditing Direct Loan and Loan Guarantee Subsidies Under the Federal Credit Reform Act, Government-wide Audited Financial Statements Task Force, Subgroup on Credit Reform (96-CR-14, October 16, 1997). In October 1997, this paper was submitted to the Accounting and Auditing Policy Committee for official release as a Technical Interpretation.

⁶Disclosure Requirements for Credit Subsidy Expense Issue Paper, Government-wide Audited Financial Statements Task Force, Credit Subgroup. In September 1997, this paper was submitted to the Accounting and Auditing Policy Committee for review and recommendation to FASAB.

Program Descriptions and Graphs of Estimated Subsidy Rates of Selected Programs

This appendix provides a brief description of the programs we selected, indicates whether the program is discretionary or mandatory, illustrates changes in the programs' estimated subsidy rates from two perspectives, and includes a brief explanation of the more significant changes in rates as provided by agencies.

The first graph for a program shows the most recently estimated total subsidy rates for each year's cohort of credit. These figures provide a snapshot of agencies' most recent estimates of the government's subsidy expense for these credit programs. Differences in the subsidy rate estimates for the different cohorts of a program may be due to improved estimates (perhaps from greater experience) or to changes in program characteristics or economic conditions.

The second graph for a program profiles the estimated subsidy rates of a given cohort over time. We graphed the fiscal year 1992 cohorts because they were more likely to have the most extensive subsidy reestimate data. We graphed fiscal year 1994 data for Education's Ford Direct Loan Program because the program began in that year and, therefore, it is the first year for which data were available. These figures depict changes over time in the agencies' knowledge about the cost of loans funded in a given fiscal year. Estimated subsidy rates for some programs have greater variability, as seen in the different vertical scales of the graphs.

We did not prepare either the total estimated subsidy rate or the cohort profile graphs for SBA's Disaster Loan Program. We did not prepare the cohort profile for the USDA/Farm Service Agency (FSA) Farm Operating Loan Program. Neither of the agencies provided sufficient and/or consistent data.

The figures in this appendix are based on data as reported and verified by agencies. We did not independently verify the accuracy of these data. The data points used to create these figures are shown in bold on the tables in appendix III.

**Farm Service Agency,
U.S. Department of
Agriculture**

Farm Operating, Direct Loans, Discretionary

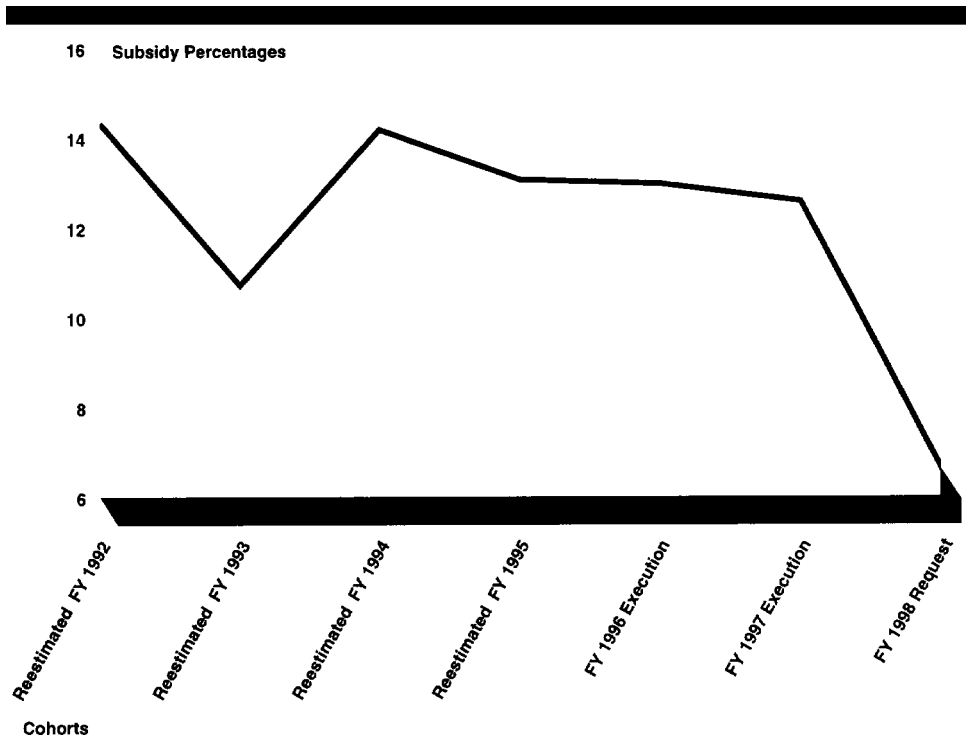
Loans are made to family farmers who are unable to obtain credit from private and cooperative sources for farm operating purposes such as purchasing livestock, poultry, and farm ranch equipment; purchasing feed, seed, or fertilizer; meeting other farm or ranch operating expenses; and paying family living expenses. The use of loan funds is intended to help provide farmers with the opportunity to conduct successful farm operations.

Agency budget officials attributed the relatively large drop in subsidy rates between the fiscal year 1997 budget execution estimate and the fiscal year 1998 budget request to the spread between the interest rates charged to borrowers and Treasury interest rates that represent the agency's cost of capital. The spread in interest rates increased nearly 100 percent for fiscal year 1998. Further, a program change for fiscal year 1998 reduced write-offs without acquired property by more than 50 percent. (See figure II.1.)

Because of changes over time in the way the FSA's Farm Operating estimated subsidy rate data were aggregated, we were not able to graph a profile of an individual cohort over time.

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**Figure II.1: USDA/FSA's Farm
 Operating Direct Loan Program's Total
 Subsidy Rates, by Cohort—as
 Estimated for the FY 1998 President's
 Budget**



**Rural Housing
Service, U.S.
Department of
Agriculture**

Single Family Housing, Direct Loans, Discretionary

Single family loans are made to very low- and low-income families who are without adequate housing and cannot obtain credit from other sources. Funds may be used to build, purchase, repair, or refinance homes in rural areas. Borrowers are required to “graduate” from the direct loan program when their incomes are sufficient to afford credit from the private sector.

For figure II.2, agency staff attributed the relatively large drop in subsidy rates between “Reestimated FY 1995” and “FY 1996 Execution” primarily to the decrease in Treasury discount interest rates and the increase in borrower interest rates. This increase in borrower interest rates is due to a change in the Rural Housing Service’s (RHS) regulations in fiscal year 1996 which reduced the payment assistance to borrowers.

Figure II.3 is influenced by P.L. 102-142, §742, which required execution rates to be at or below the rates published in the President’s fiscal year 1992 Budget. The agency used the rate in the President’s Budget because rates based on actual data would have been higher. In effect, the estimated subsidy rate was limited by law. According to agency staff, this resulted in a large first reestimate of fiscal year 1992 subsidy expense.

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Figure II.2: USDA/RHS' Section 502 Single Family Housing Direct Loan Program's Total Subsidy Rates, by Cohort—as Estimated for the FY 1998 President's Budget

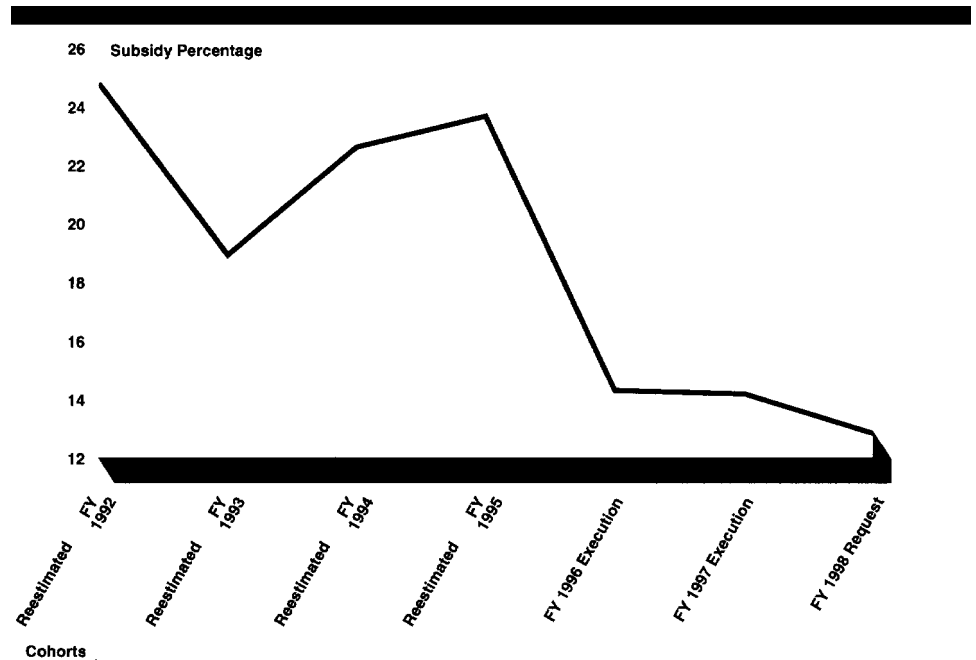
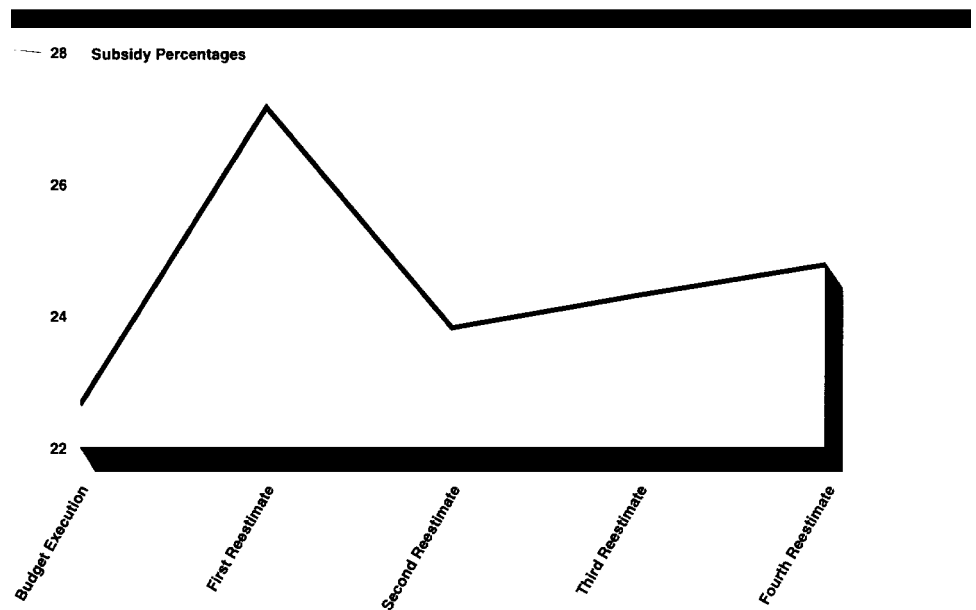


Figure II.3: USDA/RHS' Section 502 Single Family Housing Direct Loan Program's Total Subsidy Rates—Profile of the FY 1992 Cohort



**Federal Family
Education Loan
Program, Department
of Education**

Stafford, Guaranteed Loans, Mandatory

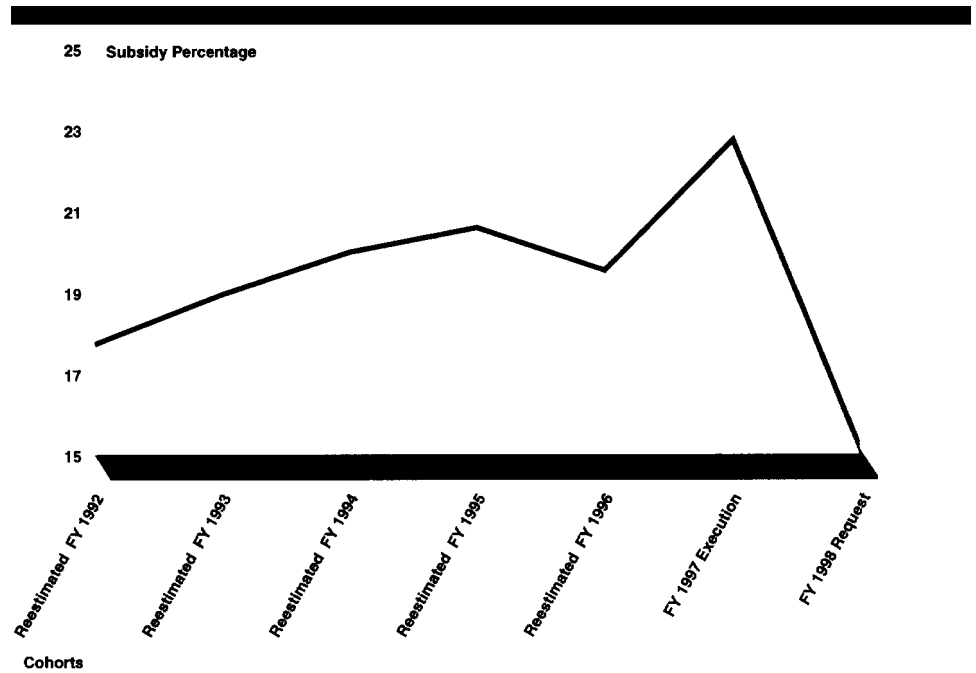
The Federal Family Education Loan Program (FFELP) is intended to encourage private lending to vocational, undergraduate, and graduate students enrolled at eligible postsecondary institutions to help pay for educational expenses. The loans are insured by a state or private nonprofit guaranty agency and reinsured by the federal government. Generally, a borrower is not required to make any payments on the principal while still in school.

As shown in figure II.4, a relatively large decrease in the estimated subsidy rate occurred between the rate used for fiscal year 1997 budget execution and the rate requested in the President's fiscal year 1998 Budget. According to Department of Education staff, this decrease was due primarily to (1) decreases in interest rates from when the reestimates were calculated to when the budget request was formulated and (2) legislative proposals included in the budget request.

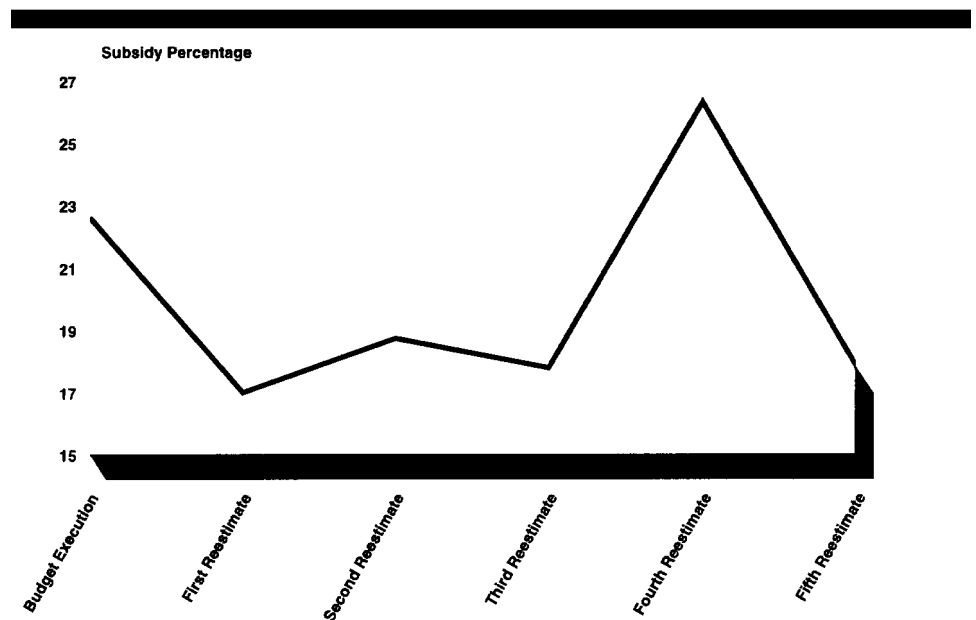
For figure II.5, Education staff attributed the relatively large increase from the third reestimate to the fourth reestimate of the fiscal year 1992 cohort's subsidy rate to a new reestimate methodology that showed higher defaults. The fifth reestimate used a methodology that showed defaults comparable to those in the third reestimate.

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**Figure II.4: Education's FFELP/Stafford
 Guaranteed Loan Program's Total
 Subsidy Rates, by Cohort—as
 Estimated for the FY 1998 President's
 Budget**



**Figure II.5: Education's FFELP/Stafford
 Guaranteed Loan Program's Total
 Subsidy Rates—Profile of the 1992
 Cohort**



Ford Direct Loan Program, Department of Education

Stafford, Direct Loans, Mandatory

To help defray costs of education at a participating school, loans are made directly from the federal government to vocational, undergraduate, and graduate students. Generally, a borrower is not required to make any payments on the principal while still in school.

For figure II.6, Department of Education staff explained that the drop in estimated subsidy rates between the latest reestimate for fiscal year 1996 and fiscal year 1997 budget execution was due primarily to decreases in interest rates from when the reestimates were calculated to when the budget request was formulated. Because of programmatic design, small changes in interest rates result in relatively larger changes in subsidy rates for direct loans than for loan guarantees.

For figure II.7, the subsidy estimate increased in the second reestimate and decreased in the third reestimate. Education staff said they used a different methodology for the second reestimate that showed higher defaults. They attributed the decrease between the second and third reestimates of the fiscal year 1994 cohort to using a methodology that showed defaults comparable to those in the first reestimate.

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Figure II.6: Education's Ford/Stafford Direct Loan Program's Total Subsidy Rates, by Cohort—as Estimated for the FY 1998 President's Budget

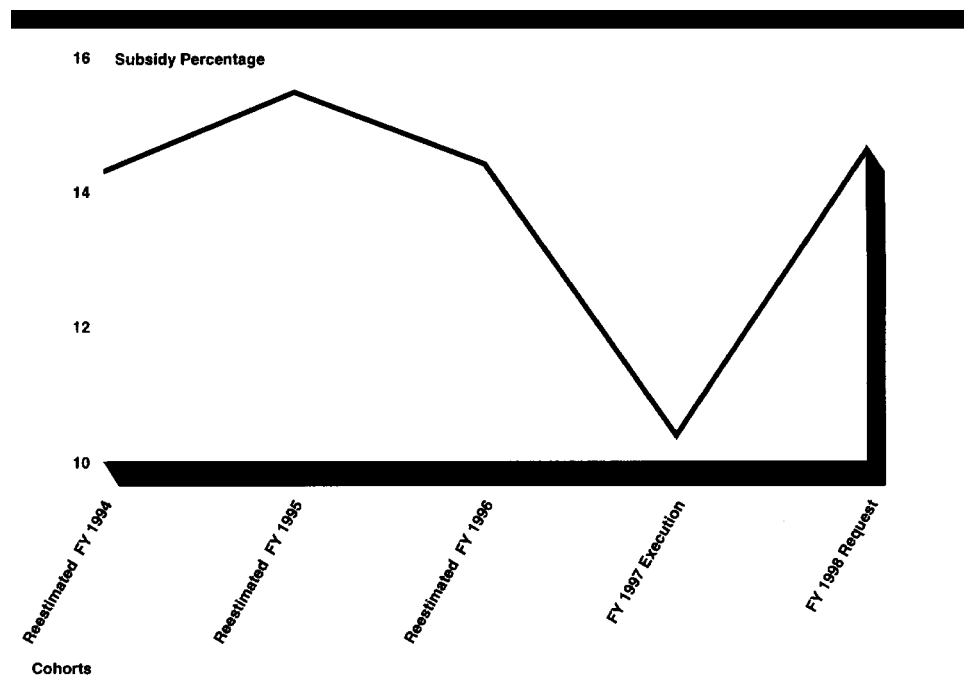
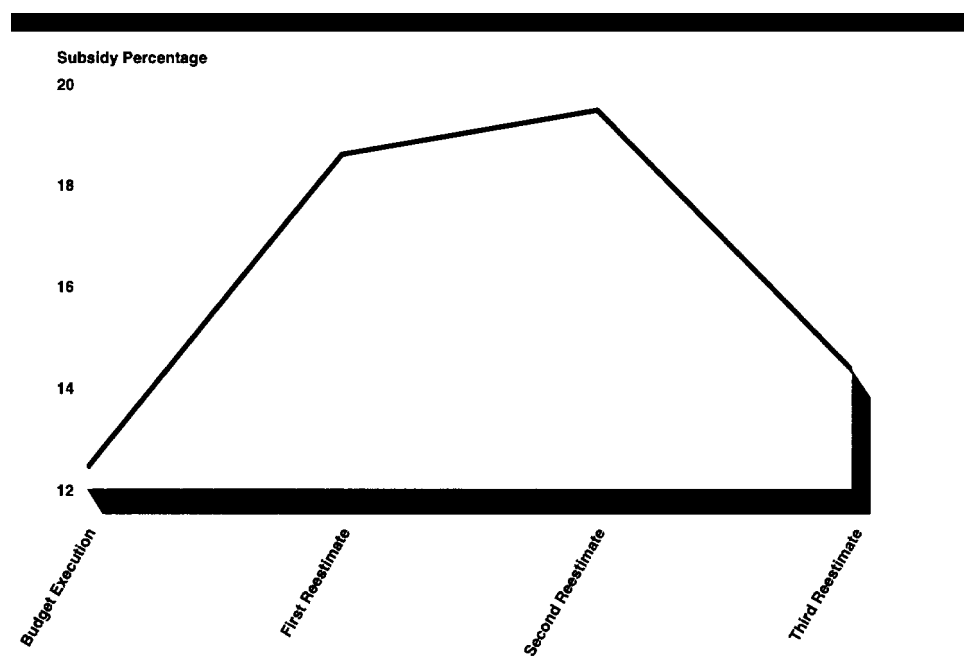


Figure II.7: Education's Ford/Stafford Direct Loan Program's Total Subsidy Rates—Profile of the FY 1994 Cohort



**Housing Programs,
Department of
Housing and Urban
Development**

**Federal Housing Administration (FHA) Mutual Mortgage Insurance
Fund, Section 203(b), Guaranteed Loans, Discretionary**

To help people become homeowners, HUD provides insurance to lenders against losses on mortgage loans. These mortgage loans may be used to finance the purchase of one-to-four family housing that is proposed, under construction, or existing, as well as to refinance indebtedness on existing housing.

As shown in figure II.8, there was a relatively large increase in the reestimated subsidy rates (in this case, a smaller negative subsidy) between the fiscal year 1994 and 1995 cohorts. According to HUD officials, this increase was driven primarily by an increase in total claim rates—from 4.95 percent for the fiscal year 1994 cohort in the 1998 Budget to 8.01 percent for the fiscal year 1995 cohort in the 1998 Budget.

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Figure II.8: HUD's Mutual Mortgage Insurance Fund's (203(b)) Guaranteed Loan Program's Total Subsidy Rates, by Cohort—as Estimated for the FY 1998 Budget Request and Reestimated for the FY 1997 President's Budget

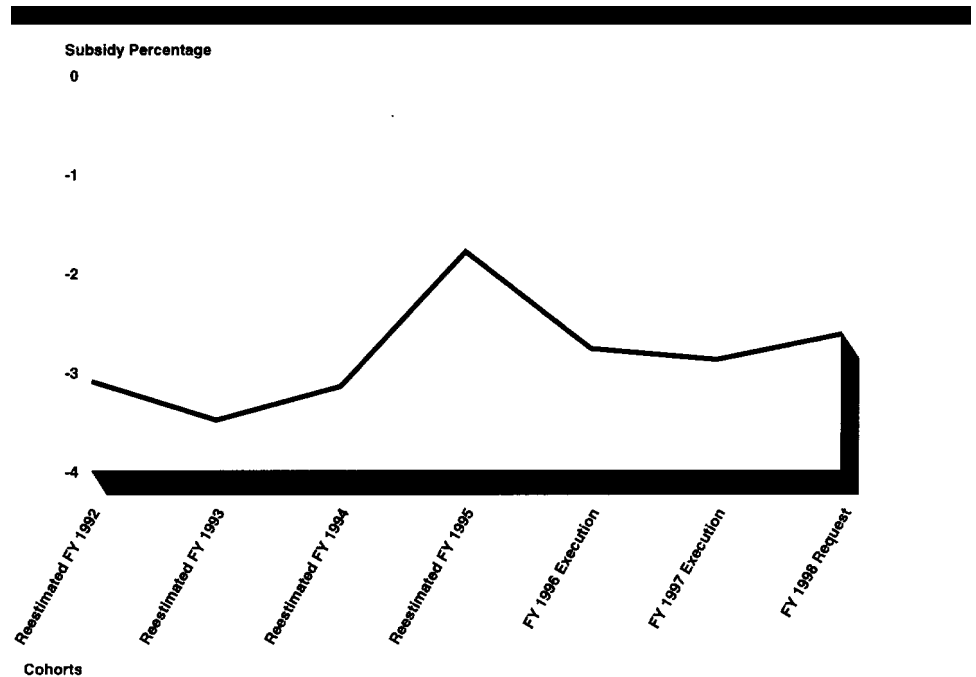
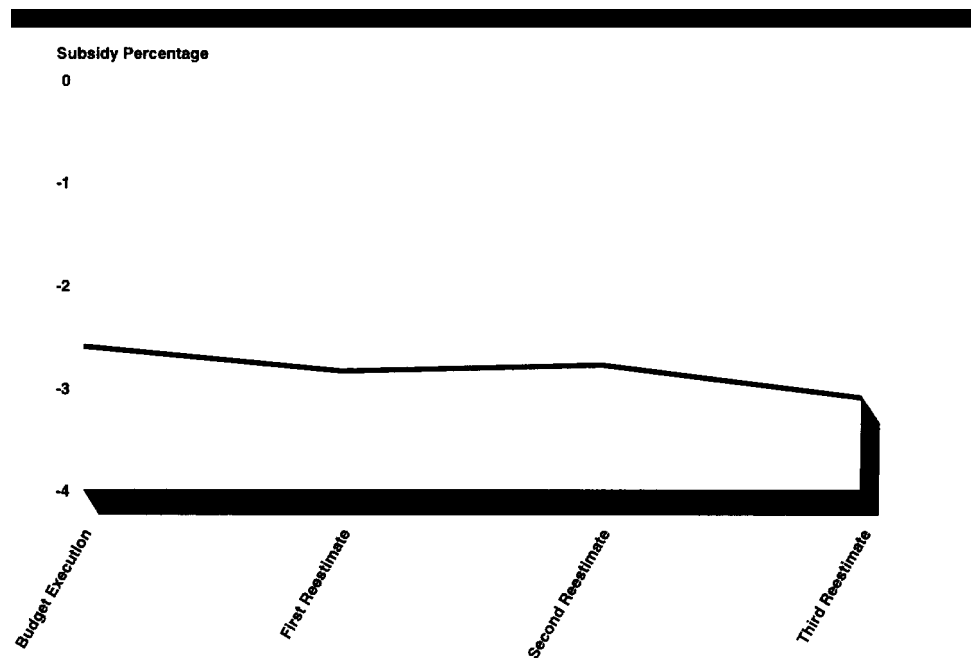


Figure II.9: HUD's Mutual Mortgage Insurance Fund's (203(b)) Guaranteed Loan Program's Total Subsidy Rates—Profile of the FY 1992 Cohort



**Housing Programs,
Department of
Housing and Urban
Development**

**FHA General and Special Risk Insurance Fund, Multifamily
Refinance 223(f), Guaranteed Loans, Discretionary**

Lenders are insured against loss on the purchase or refinance of existing multifamily housing projects. Only rental housing projects not requiring substantial rehabilitation are eligible.

Figure II.10 shows a sharp decline in estimated subsidy rates for this program between the budget execution rates in fiscal years 1996 and 1997. According to HUD officials, this decline reflects the use of updated assumptions in fiscal year 1997. These new assumptions incorporated an additional 5 years of performance data as well as the initial experience of FHA's mortgage sales.

As shown in figure II.11, there was a sharp drop between the second and third reestimated subsidy rates of the fiscal year 1992 cohort. HUD officials attributed this downward shift to a lower estimate for defaults and a higher estimate for fees.

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Figure II.10: HUD/FHA's General and Special Risk Insurance Fund, Multifamily Refinance (223(f)) Guaranteed Loan Program's Total Subsidy Rates, by Cohort—as Estimated for the FY 1998 Budget Request and Reestimated for the FY 1997 President's Budget

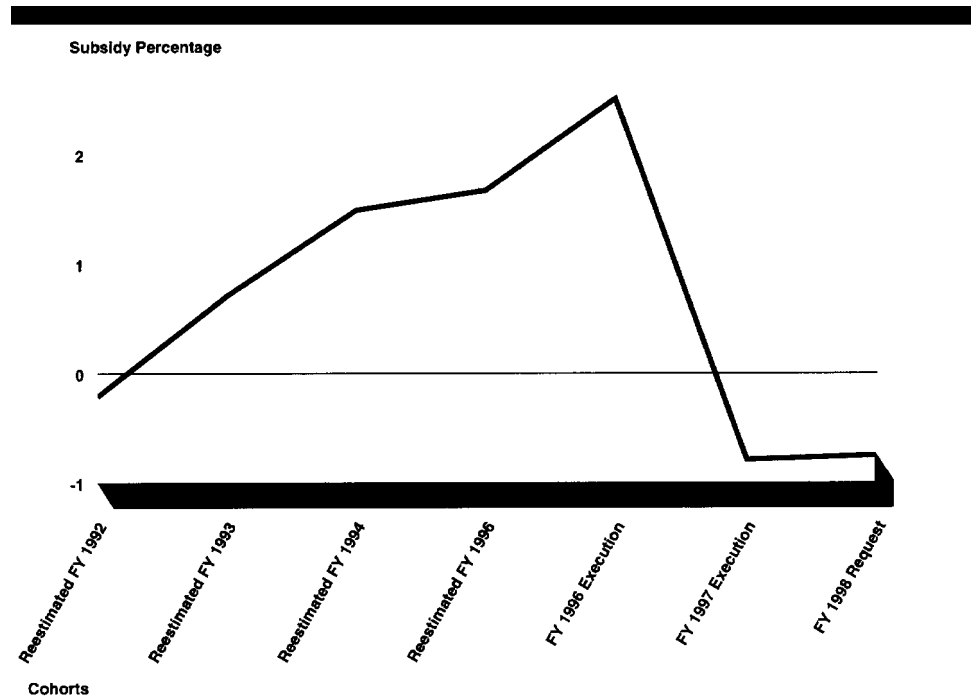
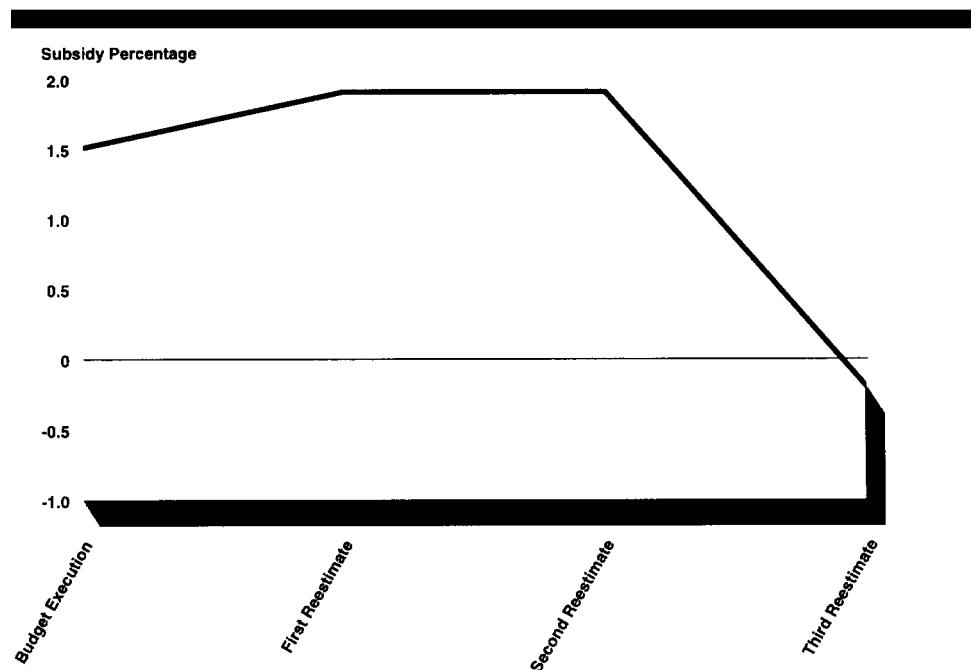


Figure II.11: HUD/FHA's General and Special Risk Insurance Fund, Multifamily Refinance (223(f)) Guaranteed Loan Program's Total Subsidy Rates—Profile of the FY 1992 Cohort



Small Business Administration

7(a) General Business, Guaranteed Loans, Discretionary

Lenders are guaranteed against loss from loans to small businesses that are unable to obtain financing in the private credit market but can demonstrate the ability to repay loans. Guaranteed loans are made available to low-income business owners or businesses located in areas of high unemployment; nonprofit sheltered workshops and other similar organizations that produce goods or services; and to small businesses being established, acquired, or owned by handicapped individuals.

For figure II.12, Small Business Administration (SBA) officials attributed the increase in reestimated subsidy rates between fiscal years 1994 and 1995 primarily to an increase in the assumed purchase rate from 16.85 percent to 17.25 percent. The purchase rate is the percent of remaining principal and interest on defaulted guaranteed loans that SBA expects to pay in claims from lenders. The following year's decrease, they explained, resulted primarily from the imposition of new and/or modified program fees.

For figure II.13, SBA officials explained that the changes in subsidy rates estimated for the fiscal year 1992 cohort were due in part to changes in the discount rate and in part to differences between anticipated and actual purchase activity, fee collections, and recoveries.

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Figure II.12: SBA's 7(a) Program's Total Subsidy Rates, by Cohort—as Estimated for the FY 1998 President's Budget

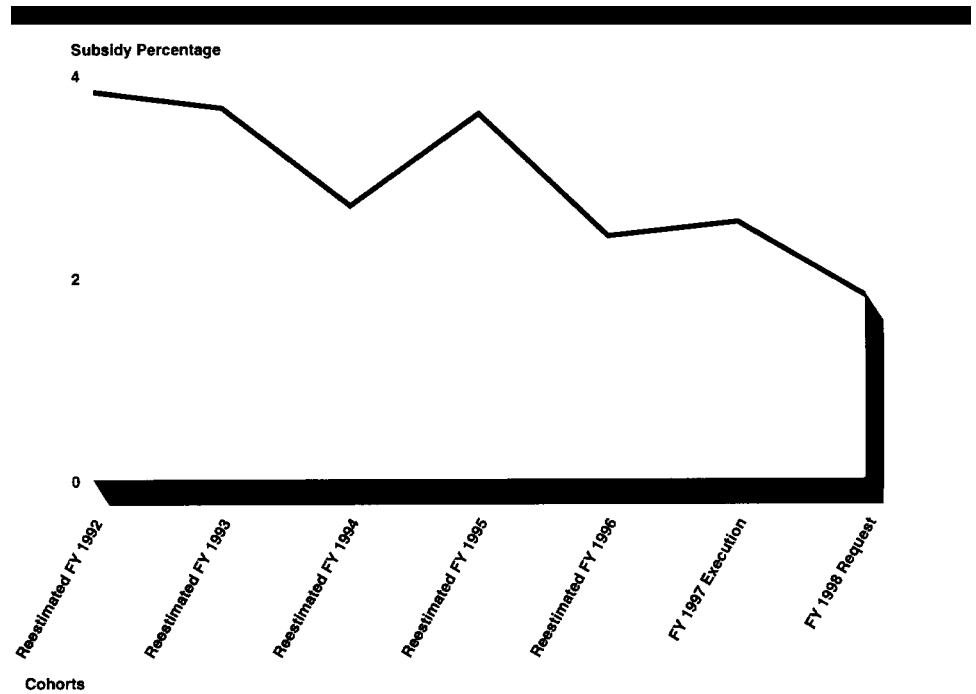
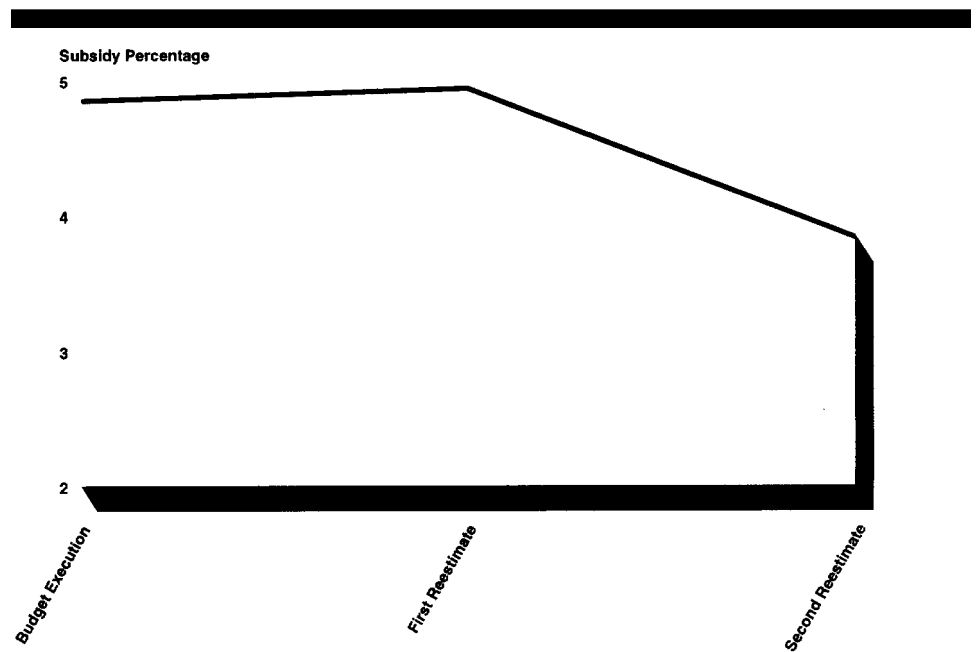


Figure II.13: SBA's 7(a) Program's Total Subsidy Rates—Profile of the FY 1992 Cohort



**Small Business
Administration**

Disaster, Direct Loans, Discretionary

Loans are made to homeowners, renters, businesses of all sizes, and nonprofit organizations that have suffered uninsured physical property loss as a result of a disaster in an area declared eligible for assistance by the President or SBA. The loans may be used to repair and/or replace property to predisaster conditions.

SBA did not provide sufficient data on this program to allow us to graph either the total subsidy rate estimates for each cohort or a profile of an individual cohort.

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**Veterans Benefits
Administration,
Department of
Veterans Affairs**

Guaranty and Indemnity Fund, Guaranteed Loans, Mandatory

These loans assist veterans and certain others in obtaining credit for the purchase, construction, or improvement of homes on more favorable terms than are generally available to nonveterans. Lenders are guaranteed partial repayment of loans made to these individuals.

As shown in figure II.14, a relatively sharp decline in reestimated subsidy rates occurred from the fiscal year 1993 cohort to the fiscal year 1995 cohort. Department of Veterans Affairs (VA) staff attributed this decline primarily to changes in foreclosure rates, discount rates, and funding fees, as well as the application of actual cohort data.

Figure II.15 shows a decline between the third and fourth reestimates of the fiscal year 1992 cohort. VA officials said this decline was a result of increased inflows from recoveries and the effect of having more actual cohort data.

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Figure II.14: VA/VBA's Guaranty and Indemnity Fund, Guaranteed Loan Financing Account's Total Subsidy Rates, by Cohort—as Estimated for the FY 1997 President's Budget

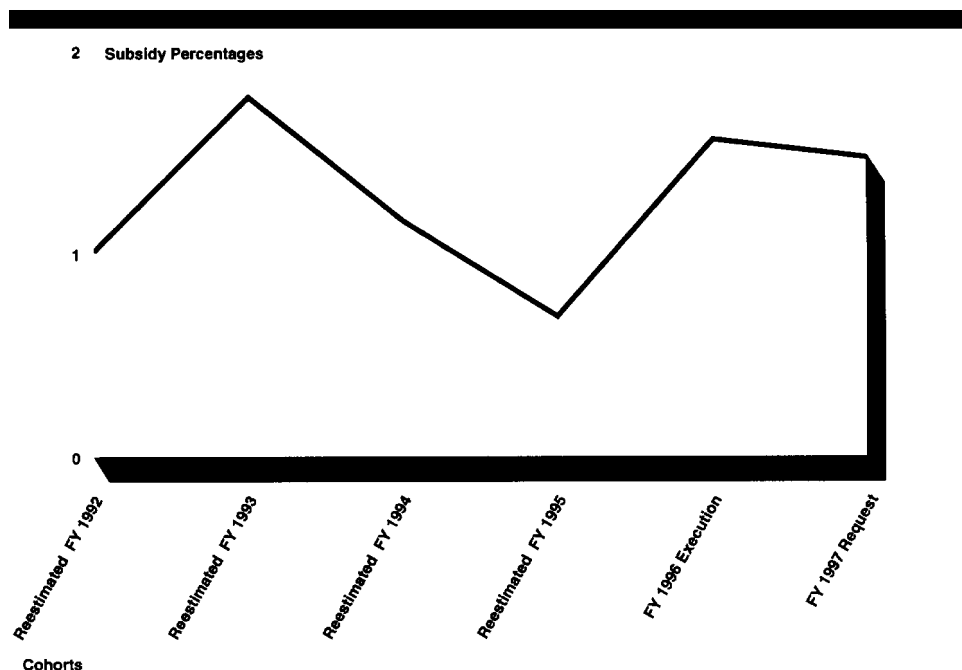
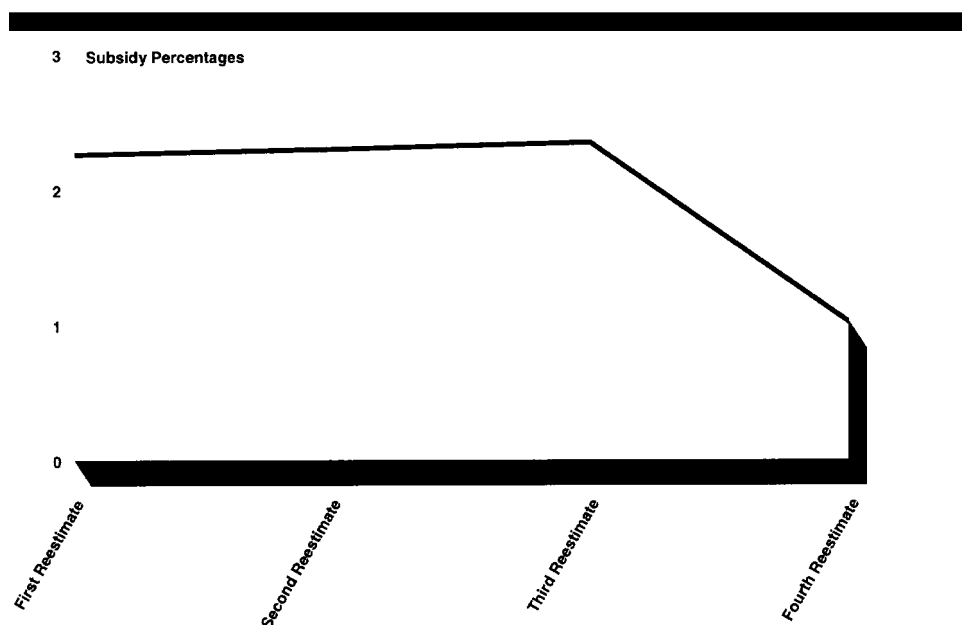


Figure II.15: VA/VBA's Guaranty and Indemnity Fund, Guaranteed Loan Financing Account's Total Subsidy Rates—Profile of the FY 1992 Cohort



Note: Fiscal year 1992 budget execution estimates were calculated quarterly. Therefore, the data provided were not comparable to the other reported data and were not graphed.

**Veterans Benefits
Administration,
Department of
Veterans Affairs**

Loan Guaranty Direct Loans, Mandatory

This program makes home loans on favorable terms to members of the general public—both veterans and nonveterans—purchasing a VA-owned property. These properties include homes that VA has acquired as a result of foreclosures on VA guaranteed loans.

Figure II.16 shows that a dramatic drop in reestimated subsidy rates occurred between the fiscal years 1994 and 1995 cohorts. According to VA staff, this decrease is associated primarily with the inclusion of actual cohort data as well as a significant increase in the estimated proceeds from loan sales.

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Figure II.16: VA/VBA's Loan Guaranty Direct Loan Financing Account's Total Subsidy Rates, by Cohort—as Estimated for the FY 1997 President's Budget

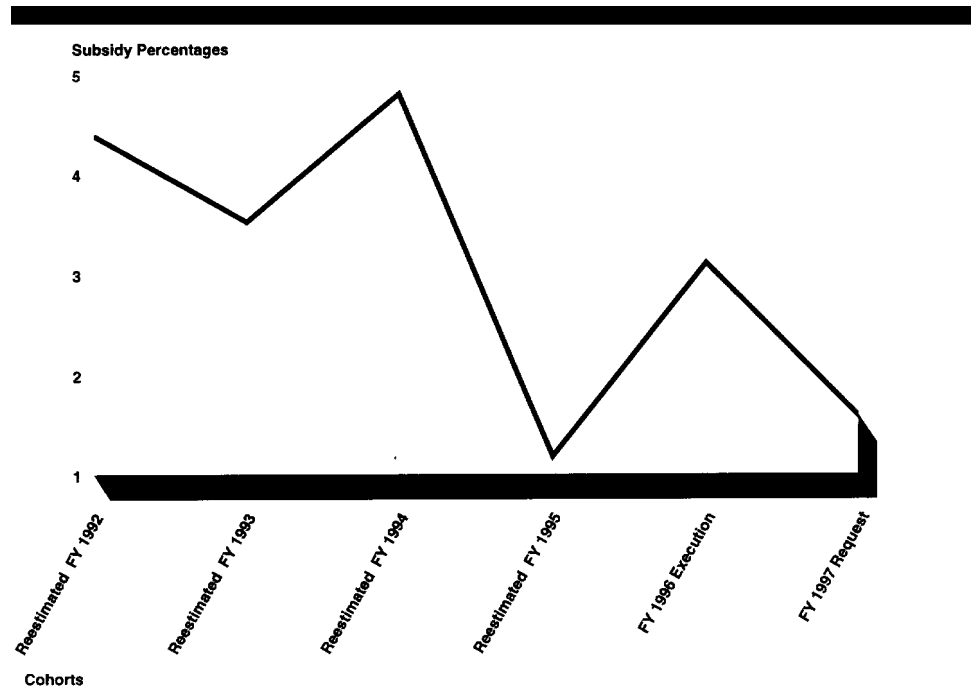
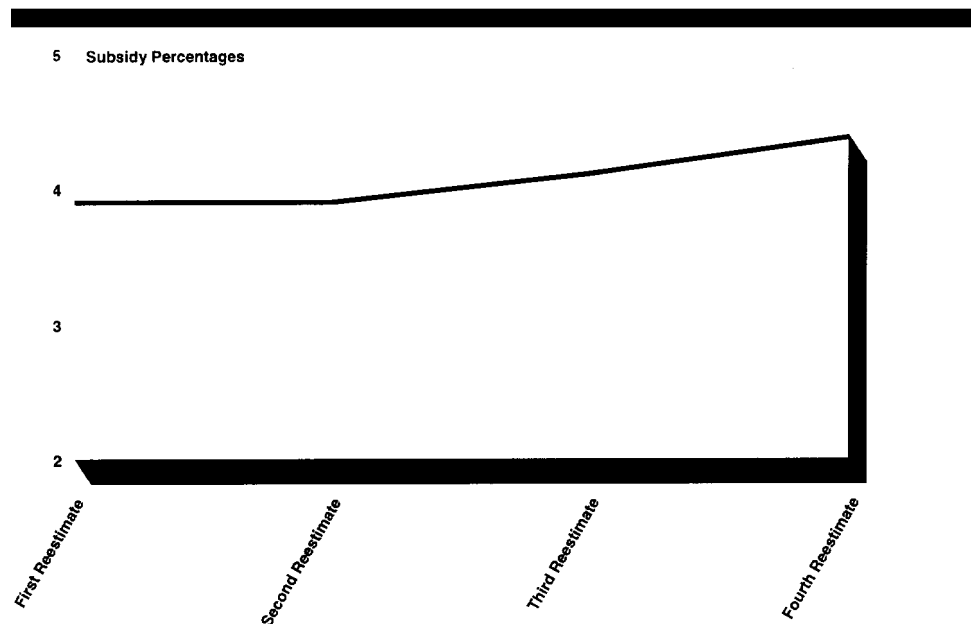


Figure II.17: VA/VBA's Loan Guaranty Direct Loan Financing Account's Total Subsidy Rates—Profile of the FY 1992 Cohort



Note: Fiscal year 1992 budget execution estimates were calculated quarterly. Therefore, the data provided were not comparable to the other reported data and were not graphed.

Estimated Subsidy Rates of Selected Programs

This appendix presents a summary of the completeness of estimated subsidy rate data and supporting documentation provided by each agency. The estimated subsidy rates, as reported and confirmed by each agency, are also shown for the 10 programs. We did not examine the quality of the data underlying the subsidy estimates or the agencies' estimation process.

We determined whether the budget request estimate, the budget execution estimate, and all reestimates for each fiscal year were supported by output from OMB's credit subsidy model and cash flow spreadsheets. Table 1 summarizes the completeness of these data. Although we did not examine the data quality, some quality issues jumped out. We found 11 instances where data confirmed by agencies did not agree with those reported in the President's Budget or Credit Supplement. When questioned about this, agencies provided additional data supporting the President's Budget in four instances. For the remaining seven cases, we show the estimated subsidy rates that were supported in agency documentation.

We also did not evaluate the timeliness or frequency of the reestimates. Currently, agencies do not necessarily reestimate prior year cohorts on the same schedule. According to the June 23, 1997, version of OMB Circular A-11, section 33.5(s), "Reestimates must be made at the beginning of each fiscal year, as long as any loans in the cohort are outstanding, unless a different plan is approved by OMB." In other words, the first reestimate of the fiscal year 1996 cohort generally should be included in the fiscal year 1998 budget request. OMB has permitted some agencies to vary from this schedule. USDA, for example, received a waiver from OMB allowing its reestimates to be prepared in the middle of the fiscal year rather than the beginning. Therefore, updated cost information from USDA's first reestimate of the fiscal year 1996 cohort would not be included in the budget submission until the fiscal year 1999 budget request.

Although we did not independently verify the data provided by agencies, the numerous modified audit opinions these agencies have received on their credit programs, the discrepancies we found between the Budget and the data provided to us by the agencies, and other work we have done¹ raise serious concerns about the quality of the data. For example, USDA's Office of the Inspector General (OIG) rendered a qualified opinion on the fiscal year 1996 financial statements of the rural development mission area

¹For example, see HUD Management: FHA's Multifamily Loan Loss Reserves and Default Prevention Efforts ([GAO/RCED/AIMD-95-100](#), June 5, 1995); Small Business Administration: Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs ([GAO/T-RCED-97-197](#), July 16, 1997); and Homeownership: Appropriations Made to Finance VA's Housing Program May Be Overestimated ([GAO/RCED-93-173](#), September 8, 1993).

because the OIG was not able to obtain sufficient, competent evidence to support the agency's credit program receivables and estimated losses on loan guarantees and the related credit program subsidy and appropriated capital used. For fiscal year 1996, Education's OIG also was unable to render an audit opinion on the department's credit activities due to auditor concerns about the integrity of the data supporting estimates of the Federal Family Education Loan Program. HUD received a qualified audit opinion from its OIG in fiscal year 1996 because FHA's credit-related accounts were not converted to a present value basis, as required by the Statement of Federal Financial Accounting Standards, No. 2, Accounting for Direct Loans and Loan Guarantees. Consequently, the OIG was unable to audit the credit-related account balances.

Tables III.1 through III.10 present the subsidy rate estimates reported and confirmed by each agency. The columns represent each budget year—1992 through 1998—since credit reform was enacted. Each table is horizontally divided into five sections. The top section of each table shows the total subsidy rate estimated and reestimated for each cohort, as calculated at different points in time. The four bottom sections represent the components of subsidy expense—interest, net defaults, fees and other collections, and other subsidy costs.² These four components add to the total subsidy rate.

The following is an excerpt of the top section from table III.3, presented to illustrate how subsidy rate data are arrayed. Because the bottom sections organizationally mirror the top section, only the top section is shown in this example.

²The fourth component category, other subsidy costs, primarily reflects estimated prepayments.

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Total Subsidy Rate (in percent)

Time of estimate	Cohorts						
	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
Request	22.60	17.60	14.24	15.31	22.84	19.77	15.09
Execution	22.60	17.60	15.59	15.31	22.84	22.75	
Reestimate 1	16.99	17.55	17.07	23.09	19.55		
Reestimate 2	18.73	18.90	22.13	20.60			
Reestimate 3	17.78	22.74	20.00				
Reestimate 4	26.30	18.96					
Reestimate 5	17.74						

The seven columns labeled “Cohorts” contain the available budget request, budget execution, and reestimated subsidy rates for the credit funded by appropriations in the indicated fiscal year. The left-hand column contains the type of estimate prepared and gives some indication about when the estimate was calculated. Thus, the first row, labeled “Request,” shows the subsidy rate used to prepare the budget year request for that fiscal year. In the sample table above, the fiscal year 1992 budget request used an estimated subsidy rate of 22.60 percent. Reading down the fiscal year 1992 column, the budget execution rate shows the subsidy rate estimated for the fiscal year 1992 cohort after the beginning of fiscal year 1992—after the appropriation was received but before loans were made. Reestimate data are shown in the order in which they were prepared.

The shaded cells represent estimates that will be made in the future when future budgets are prepared (e.g., the budget execution estimate for fiscal year 1998 and the first reestimate of fiscal year 1997 should have been done for the fiscal year 1999 budget.) The numbers from these tables that support the graphs in appendix II are shown in bold.

For cells that are neither shaded nor filled in with data, the estimated subsidy rate was not provided. The absence of the data might reflect incomplete agency files or indicate that the agency did not prepare estimates. Notes to the tables provide additional explanatory information in some instances when data were not provided.

OMB has periodically released updated versions of its credit subsidy model. Several of these versions aggregated the component data differently. For example, early versions of the model combined the two components “Fees

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and Other Collections” and “Other Subsidy Costs.” We showed all comparable data provided by the agencies.

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**Table III.1: USDA/FSA: Farm Operating
Direct Loan Program Subsidy Rates**

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	a	a	a	a	13.70	13.29	6.57
Execution	ab	ab	ab	a	12.98	12.59	
Reestimate 1	a	a	14.05	13.07			
Reestimate 2	a	10.51	14.18				
Reestimate 3	8.96	10.72					
Reestimate 4	14.32						
Reestimate 5							

^aUSDA provided subsidy rate estimates that were divided into four sub-risk categories. Therefore, the data were not comparable to the other reported data and were not included in this table.

^bUSDA provided quarterly subsidy rate estimates. Therefore, the data were not comparable to the other reported data and were not included in this table.

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request	a	a	a	a	1.14	-0.73	0.16
Execution	ab	ab	ab	a	1.04	-0.39	
Reestimate 1	a	a	1.13	0.25			
Reestimate 2	a	-2.39	0.89				
Reestimate 3		-1.86					
Reestimate 4	3.95						
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request	a	a	a	a	12.59	13.85	6.23
Execution	ab	ab	ab	a	11.96	12.84	
Reestimate 1	a	a	12.56	12.72			
Reestimate 2	a	13.08	12.66				
Reestimate 3		12.84					
Reestimate 4	12.75						
Reestimate 5							
Fees Component of Subsidy Expense							
Request	a	a	a	a	-21.43	-23.75	-21.76
Execution	ab	ab	ab	a	-20.37	-21.83	
Reestimate 1	a	a	-21.72	-21.56			
Reestimate 2	a	-26.55	-18.40				
Reestimate 3		-24.24					
Reestimate 4	-8.51						
Reestimate 5							
All Other Component of Subsidy Expense							
Request	a	a	a	a	21.40	23.92	21.93
Execution	ab	ab	ab	a	20.35	21.96	
Reestimate 1	a	a	22.08	21.67			
Reestimate 2	a	26.37	19.04				
Reestimate 3		23.98					
Reestimate 4	6.12						
Reestimate 5							

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**Table III.2: USDA/RHS: Section 502
Single Family Housing Direct Loan
Program Subsidy Rates**

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	22.64	24.35	20.02	9.20	20.99	8.30	12.81
Execution	22.64	^a	^a	24.36	14.30	14.18	
Reestimate 1	27.16	19.73	23.07	23.66			
Reestimate 2	23.81	20.12	22.60				
Reestimate 3	24.31	18.90					
Reestimate 4	24.78						
Reestimate 5							

^aUSDA provided quarterly subsidy rate estimates. Therefore, the data were not comparable to the other reported data and were not included in this table.

^bComparable data for "Fees" and "Other Subsidy Cost" components were not provided.

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request		28.67	23.08	5.23	27.29	9.63	15.69
Execution		a	a	27.94	17.06	17.01	
Reestimate 1	30.49	22.28	24.91	27.62			
Reestimate 2	28.21	23.08	25.80				
Reestimate 3	29.00	22.41					
Reestimate 4	27.51						
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request		1.68	1.48	5.20	0.26	1.59	1.12
Execution		a	a	1.13	1.08	1.20	
Reestimate 1	1.05	1.60	1.34	1.19			
Reestimate 2	0.91	1.52	0.95				
Reestimate 3	0.73	0.57					
Reestimate 4	0.93						
Reestimate 5							
Fees Component of Subsidy Expense							
Request		b	-10.10	-16.46	-7.98	-7.74	-7.10
Execution		a	a	-12.59	-10.63	-7.12	
Reestimate 1	ab	-13.46	-33.63	-5.75			
Reestimate 2	-9.63	-13.50	-13.31				
Reestimate 3	-9.88	-13.59					
Reestimate 4	-10.09						
Reestimate 5							
All Other Component of Subsidy Expense							
Request		b	5.56	15.22	1.41	4.83	3.09
Execution		a	a	7.89	6.79	3.09	
Reestimate 1	b	9.32	30.46	0.59			
Reestimate 2	4.33	9.01	9.15				
Reestimate 3	4.45	9.51					
Reestimate 4	6.43						
Reestimate 5							

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Table III.3: Education: FFELP/Stafford
Guaranteed Loan Program Subsidy
Rates

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	22.60	17.60	14.24	15.31	22.84	19.77	15.09
Execution	22.60	17.60	15.59	15.31	22.84	22.75	
Reestimate 1	16.99	17.55	17.07	23.09	19.55		
Reestimate 2	18.73	18.90	22.13	20.60			
Reestimate 3	17.78	22.74	20.00				
Reestimate 4	26.30	18.96					
Reestimate 5	17.74						

Note: According to officials from Education, they do not use the OMB credit subsidy model as the final step in the subsidy estimation process, as is done in other agencies. Education uses it at an earlier point in the process—before adjustments are made for external factors. Therefore, output from this model did not reflect data used to prepare the budget request and budget execution estimated subsidy rates. Reestimates, however, are not adjusted and thus reflect the results from OMB's model.

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Programs

(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request				15.58	18.14	15.85	10.35
Execution			11.31	15.58	18.14	15.85	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request				6.76	8.47	7.85	6.81
Execution			8.06	6.76	8.47	9.46	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
Fees Component of Subsidy Expense							
Request				-3.78	-3.77	-4.86	-3.45
Execution			-4.89	-3.78	-3.77	-3.50	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
All Other Component of Subsidy Expense							
Request				-3.25	0.00	0.93	1.39
Execution			1.11	-3.25	0.00	0.94	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							

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Table III.4: Education: Ford/Stafford
Direct Loan Program Subsidy Rates

(In percent)					
Time of Estimate	Cohorts				
	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate					
Request	11.39	14.45	16.54	10.17	14.65
Execution	12.42	14.45	16.54	10.38	
Reestimate 1	18.59	17.38	14.40		
Reestimate 2	19.47	15.47			
Reestimate 3	14.29				

Notes: (1) The Ford Direct Loan Program was established in fiscal year 1994. (2) According to officials from Education, they do not use the OMB credit subsidy model as the final step in the subsidy estimation process, as is done in other agencies. Education uses it at an earlier point in the process—before adjustments are made for external factors. Therefore, output from this model did not reflect data used to prepare the budget request and budget execution estimated subsidy rates. Reestimates, however, are not adjusted and thus reflect the results from OMB's model.

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(In percent)

Time of Estimate	Cohorts				
	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense					
Request		9.68	12.64	3.16	8.20
Execution	9.39	9.68	12.64	3.16	
Reestimate 1					
Reestimate 2					
Reestimate 3					
Net Defaults Component of Subsidy Expense					
Request		7.59	6.88	9.56	8.13
Execution	8.76	7.59	6.88	9.56	
Reestimate 1					
Reestimate 2					
Reestimate 3					
Fees Component of Subsidy Expense					
Request		-3.53	-4.00	-3.95	-2.95
Execution	-6.45	-3.53	-4.00	-3.95	
Reestimate 1					
Reestimate 2					
Reestimate 3					
All Other Component of Subsidy Expense					
Request		0.72	1.03	1.41	1.28
Execution	0.72	0.72	1.03	1.62	
Reestimate 1					
Reestimate 2					
Reestimate 3					

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**Table III.5: HUD: Mutual Mortgage
Insurance Fund (Section 203(b))
Guaranteed Loan Program Subsidy
Rates**

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	-2.60	-2.70	-2.79	-2.78	-2.77	-2.33	-2.62
Execution	-2.60	-2.57	-2.79	-1.95	-2.77	-2.88	
Reestimate 1	-2.84	-3.67	-3.40	-1.79			
Reestimate 2	-2.78	-3.49	-3.15				
Reestimate 3	-3.10						
Reestimate 4							
Reestimate 5							

^aComparable data for "Fees" and "Other Subsidy Cost" components were not provided.

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request	0.00		0.00		0.00	0.00	0.00
Execution	0.00		0.00	0.00	0.00		
Reestimate 1	0.00	0.00	0.00	0.00			
Reestimate 2	0.00	0.00	0.00				
Reestimate 3	0.00						
Reestimate 4							
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request	2.49		2.26		1.70	1.85	1.46
Execution	2.49		2.26	1.84	1.70		
Reestimate 1	2.33	1.40	1.40	2.18			
Reestimate 2	1.88	1.40	1.26				
Reestimate 3	1.71						
Reestimate 4							
Reestimate 5							
Fees Component of Subsidy Expense							
Request	a		a		-5.24	-5.21	-4.88
Execution	a		a	-4.69	-5.24		
Reestimate 1	a	-5.92	-5.42	-5.10			
Reestimate 2	-5.72	-5.72	-5.14				
Reestimate 3	-5.92						
Reestimate 4							
Reestimate 5							
All Other Component of Subsidy Expense							
Request	a		a		0.78	1.03	0.81
Execution	a		a	0.90	0.78		
Reestimate 1	a	0.84	0.62	1.13			
Reestimate 2	1.06	0.82	0.72				
Reestimate 3	1.11						
Reestimate 4							
Reestimate 5							

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Table III.6: HUD/FHA: General and Special Risk Insurance Fund, Multifamily Refinance 223(f), Guaranteed Loan Program Subsidy Rates

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	1.51	2.98	3.14	3.20	2.30	-0.79	-0.75
Execution	1.51	2.98	3.34	3.40	2.51	-0.79	
Reestimate 1	1.91	3.04	1.49	1.67			
Reestimate 2	1.91	0.71					
Reestimate 3	-0.21						
Reestimate 4							
Reestimate 5							

^aComparable data for "Fees" and "Other Subsidy Cost" components were not provided.

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request		0.00	0.00	0.00	0.00	0.00	0.00
Execution		0.00				0.00	
Reestimate 1		0.00	0.00	0.00			
Reestimate 2	0.00	0.00					
Reestimate 3	0.00						
Reestimate 4							
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request		7.39	7.64	7.82	7.24	5.21	5.02
Execution		7.39				5.21	
Reestimate 1		7.55	6.85	7.27			
Reestimate 2	6.78	5.96					
Reestimate 3	5.52						
Reestimate 4							
Reestimate 5							
Fees Component of Subsidy Expense							
Request		a	a	-4.62	-4.94	-6.00	-5.77
Execution		a				-6.00	
Reestimate 1		-4.51	-4.44	-4.54			
Reestimate 2	-4.88	-5.25					
Reestimate 3	-5.73						
Reestimate 4							
Reestimate 5							
All Other Component of Subsidy Expense							
Request		a	a	0.00	0.00	0.00	0.00
Execution		a				0.00	
Reestimate 1		0.00	-0.92	-1.06			
Reestimate 2	0.00	0.00					
Reestimate 3	0.00						
Reestimate 4							
Reestimate 5							

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**Table III.7: SBA: 7(a) Guaranteed Loan
Program Subsidy Rates**

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	0.60	1.35	2.35	2.73	2.01	2.68	1.80
Execution	4.85	5.21	2.15	2.74	1.06	2.54	
Reestimate 1	4.94	4.97	2.91	2.97	2.40		
Reestimate 2	3.83	3.67	2.70	3.61			
Reestimate 3							
Reestimate 4							
Reestimate 5							

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request				0.00	0.00	0.00	0.00
Execution			0.00	0.00	0.00	0.00	
Reestimate 1	0.00	0.00	0.00	0.00	0.00		
Reestimate 2	0.00	0.00	0.00	0.00			
Reestimate 3							
Reestimate 4							
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request				5.13	5.08	8.25	5.33
Execution			4.88	5.07	5.51	8.05	
Reestimate 1	6.79	6.95	4.82	5.51	5.88		
Reestimate 2	5.73	5.68	4.68	5.61			
Reestimate 3							
Reestimate 4							
Reestimate 5							
Fees Component of Subsidy Expense							
Request				-2.52	-3.22	-5.57	-3.53
Execution			-2.87	-2.47	-4.57	-5.50	
Reestimate 1	-1.85	-1.97	-2.18	-2.81	-3.48		
Reestimate 2	-1.85	-2.01	-1.98	-2.00			
Reestimate 3							
Reestimate 4							
Reestimate 5							
All Other Component of Subsidy Expense							
Request				0.11	0.15	0.00	0.00
Execution			0.13	0.15	0.12	0.00	
Reestimate 1	0.00	0.00	0.27	0.27	0.00		
Reestimate 2	0.00	0.00	0.00	0.00			
Reestimate 3							
Reestimate 4							
Reestimate 5							

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**Table III.8: SBA: Disaster Direct Loan
Program Subsidy Rates**

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	22.50	8.21	12.79	12.67	8.46	7.90	11.44
Execution	33.93	20.58	22.99	31.54	28.08	20.02	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							

^aComparable data for "Fees" and "Other Subsidy Cost" components were not provided.

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(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request					-3.61	-1.57	0.89
Execution			9.70	19.61	15.46	11.91	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
Net Defaults Component of Subsidy Expense							
Request					11.00	9.46	11.15
Execution	19.00	11.93	12.31	10.85	11.58	8.10	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
Fees Component of Subsidy Expense							
Request					-1.46	0.00	0.00
Execution	a	a	-1.74	0.00	-1.58	0.00	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							
All Other Component of Subsidy Expense							
Request					2.54	0.00	-0.59
Execution	a	a	2.72	1.08	2.62	0.00	
Reestimate 1							
Reestimate 2							
Reestimate 3							
Reestimate 4							
Reestimate 5							

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Table III.9: VA/VBA: Guaranty and Indemnity Fund, Guaranteed Loan Financing Account Subsidy Rates

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	1.15	1.82	1.36	1.18	1.56	1.47	0.49 ^a
Execution	^b	^b	1.36	1.18	1.56	0.49 ^{ac}	
Reestimate 1	2.26	1.11	0.98	0.69	0.42 ^a		
Reestimate 2	2.30	1.44	1.16	0.78 ^a			
Reestimate 3	2.35	1.77	0.98 ^a				
Reestimate 4	1.01	1.14 ^a					
Reestimate 5	1.15 ^a						

^aVA has consolidated its loan guarantees into one account and its direct loans into another (Public Law 105-65). The fiscal year 1998 Budget was prepared on this basis. Thus, data for the fiscal year 1998 request, the fiscal year 1997 budget execution estimate, and associated reestimates of prior years included in this table are not comparable with other data shown.

^bSubsidy rate estimates were calculated quarterly; therefore, the data provided were not comparable to the other reported data and were not included.

^cVA consolidated its programs midway through fiscal year 1997. The rate of 1.47 percent was effective from October 1996 through March 1997. From April through September 1997, the consolidated fiscal year 1998 rate of 0.49 percent was used.

Appendix III
Estimated Subsidy Rates of Selected
Programs

(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request			0.00	0.00	0.00	0.00	0.00 ^a
Execution			0.00	0.00	0.00	0.00 ^{ac}	
Reestimate 1			0.00	0.00	0.00 ^a		
Reestimate 2		0.00	0.00	0.00 ^a			
Reestimate 3	0.00	0.00	0.00 ^a				
Reestimate 4	0.00	0.00 ^a					
Reestimate 5	0.00 ^a						
Net Defaults Component of Subsidy Expense							
Request			4.38	3.31	3.86	3.95	2.60 ^a
Execution			4.38	3.31	3.86	2.60 ^{ac}	
Reestimate 1			2.69	2.99	2.45 ^a		
Reestimate 2		3.06	2.77	2.64 ^a			
Reestimate 3	4.33	3.04	2.41 ^a				
Reestimate 4	2.66	2.03 ^a					
Reestimate 5	2.54 ^a						
Fees Component of Subsidy Expense							
Request			-2.11	-1.64	-1.87	-1.95	-1.91 ^a
Execution			-2.11	-1.64	-1.87	-1.91 ^{ac}	
Reestimate 1			-1.45	-1.95	-1.84 ^a		
Reestimate 2		-1.19	-1.38	-1.78 ^a			
Reestimate 3	-1.09	-0.87	-1.40 ^a				
Reestimate 4	-1.08	-0.87 ^a					
Reestimate 5	-1.08 ^a						
All Other Component of Subsidy Expense							
Request			-0.92	-0.50	-0.43	-0.52	-0.20 ^a
Execution			-0.92	-0.50	-0.43	-0.20 ^{ac}	
Reestimate 1			-0.27	-0.35	-0.19 ^a		
Reestimate 2		-0.43	-0.24	-0.08 ^a			
Reestimate 3	-0.90	-0.39	-0.03 ^a				
Reestimate 4	-0.57	-0.03 ^a					
Reestimate 5	-0.32 ^a						

Appendix III
Estimated Subsidy Rates of Selected
Programs

Table III.10: VA/VBA: Loan Guaranty
Direct Loan Financing Account
Subsidy Rates

(In percent)							
Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Total Subsidy Rate							
Request	11.28	8.35	2.34	2.34	3.11	1.56	2.36 ^a
Execution	^b	^b	2.34	2.34	3.11	2.61 ^{ac}	
Reestimate 1	3.90	1.09	3.17	1.18	1.76 ^a		
Reestimate 2	3.90	1.27	4.80	1.38 ^a			
Reestimate 3	4.11	3.52	2.05 ^a				
Reestimate 4	4.38	0.41 ^a					
Reestimate 5	0.21 ^a						

^aVA has consolidated its loan guarantees into one account and its direct loans into another (Public Law 105-65). The fiscal year 1998 Budget was prepared on this basis. Thus, data for the fiscal year 1998 request, fiscal year 1997 budget execution estimate, and associated reestimates of prior years included in this table are not comparable with other data shown.

^bSubsidy rate estimates were calculated quarterly; therefore, the data provided were not comparable to the other reported data and were not included.

^cVA consolidated its programs midway through fiscal year 1997. The rate of 1.56 percent was effective from October 1996 through March 1997. From April through September 1997, the consolidated fiscal year 1998 rate of 2.61 percent was used.

Appendix III
Estimated Subsidy Rates of Selected
Programs

(In percent)

Time of Estimate	Cohorts						
	FY92	FY93	FY94	FY95	FY96	FY97	FY98
Interest Component of Subsidy Expense							
Request			-17.90	-9.77	-14.76	-18.21	-17.32 ^a
Execution			-17.90	-9.77	-14.76		
Reestimate 1			-12.39	-11.35	-11.11 ^a		
Reestimate 2		-9.33	-12.39	-11.35 ^a			
Reestimate 3	-13.20	-9.33	-12.39 ^a				
Reestimate 4	-11.04	-9.34 ^a					
Reestimate 5	-10.99 ^a						
Net Defaults Component of Subsidy Expense							
Request			-71.22	-71.77	-66.50	-73.08	-69.54 ^a
Execution			-71.22	-71.77	-66.50		
Reestimate 1			-69.41	-71.82	-74.86 ^a		
Reestimate 2		-77.86	-67.81	-86.92 ^a			
Reestimate 3	-77.51	-75.55	-83.47 ^a				
Reestimate 4	-77.33	-90.97 ^a					
Reestimate 5	-81.19 ^a						
Fees Component of Subsidy Expense							
Request			-3.87	-3.83	-3.68	-3.92	-3.80 ^a
Execution			-3.87	-3.83	-3.68		
Reestimate 1			-3.79	-3.80	-0.88 ^a		
Reestimate 2		-4.06	-3.76	-0.90 ^a			
Reestimate 3	-1.92	-4.01	-0.88 ^a				
Reestimate 4	-1.92	-1.05 ^a					
Reestimate 5	-1.11 ^a						
All Other Component of Subsidy Expense							
Request			95.33	87.72	88.05	96.77	93.02 ^a
Execution			95.33	87.72	88.05		
Reestimate 1			88.76	88.16	88.61 ^a		
Reestimate 2		92.53	88.76	100.55 ^a			
Reestimate 3	96.74	92.41	98.78 ^a				
Reestimate 4	94.66	101.77 ^a					
Reestimate 5	93.50 ^a						

Comments From the Office of Management and Budget

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 11, 1998

Gene L. Dodaro
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

Thank you for the opportunity to comment on GAO's draft report, "Credit Reform: Greater Effort Needed To Overcome Persistent Cost Estimation Problems."

As your report states, the primary purpose of the Federal Credit Reform Act (FCRA) is to provide a more accurate estimate of the cost of federal credit programs and to permit better cost comparisons between credit programs and between credit programs and other methods of providing assistance. The accuracy and integrity of subsidy estimates, therefore, is key to the value of credit reform. For this reason, OMB has worked with agencies to improve subsidy estimation methods and to obtain better financial data on loan performance.

We are therefore pleased that GAO has been contributing to this same effort through a series of reports on credit reform over the past few years as well as by other means. It is very valuable for a third party to study agency practices, all the more so because credit reform is still new, unusually complex, and different from budgeting for other types of Federal programs. This helps make the agencies more aware of weaknesses and the steps they need to take to improve their subsidy estimates -- whether more reliable data, better documentation, appropriate reestimates, consistency between agency reports for the budget and internal records, or correct classification of data by subsidy component. It also helps make Congress and OMB more aware of their weaknesses and the steps that are needed. The error that GAO discovered in SBA's fiscal year 1997 subsidy estimate for the section 7(a) business loan guarantees is but a striking example of what may be found. The present report, by focusing on subsidy estimation *per se*, should be especially valuable.

We are very concerned, however, that several of the report's general conclusions about subsidy estimates, as opposed to its findings of fact, are not supported by the evidence. We suggest that these flaws be corrected before the report is issued.

The report's most serious deficiency is that it fails to distinguish between the effect of interest rates on initial subsidy rates, and the effect of default and other technical factors. Subsidy rates are the present value of expected cash flows over the life of a loan divided by loan principal. Thus, subsidy rates are highly dependent on the interest rate that is used to discount the expected cash flows. A change in the discount rate will cause the subsidy rate to change, even if the cash flows are unaffected. For some programs, changes in the discount rate can cause disproportionate changes in the subsidy rate. For example, the 1997 subsidy rate for Rural Housing Service single-family direct housing loans was updated at budget execution for a 1.58

See comment 1.

Appendix IV
Comments From the Office of Management
and Budget

See comment 2.

percentage point increase in the interest rate for the first year's loan disbursements. This increased the disbursement weighted average discount rate from 5.470 percent to 6.747 percent, and increased the spread between the borrower's rate and the discount rate from 1.674 percentage points to 2.852 percentage points. As a result, the subsidy rate increased from 8.30 percent to 14.18 percent -- a 71 percent increase. Since market interest rates change frequently, the Administration revises its interest rate assumptions for the President's budget each year. As a result, subsidy rates change each year in part for reasons that have nothing to do with program changes or changes in agency estimates of future cash flows. Indeed, subsidy rates would change each year even if the default and other technical assumptions remain constant. Unless an adjustment is made for the effect of different discount rates, it is impossible to draw valid conclusions about the accuracy of subsidy rates from the observation that subsidy rates have fluctuated over time.

See comment 3.

This deficiency extends to the analysis of subsidy reestimates. The report observes that reestimates cause the subsidy rate for a cohort of loans to fluctuate from year to year. Much of this is due to interest rate reestimates, which are beyond the control of credit agency officials and can often dwarf the default and other technical reestimates. The initial subsidy rates at the time of disbursement are necessarily based on certain interest rate assumptions. Under OMB guidance in effect during the period of this study, agencies were required to perform an interest rate reestimate after the close of the fiscal year for each cohort that disbursed or guaranteed loans that year, in order to correct for the difference between the assumed interest rate and the actual average interest rate for the year. If a cohort disbursed over several years, it would have had multiple interest rate reestimates. From the standpoint of assessing the accuracy of programmatic assumptions, interest rate reestimates do not matter. Errors in the interest rate assumptions are due to changes in the overall economy, not the agency's assumptions about credit. Unless their effect is removed, it is impossible to draw valid conclusions about a program from the size or direction of subsidy reestimates.

See comment 4.

See comment 5.

Secondly, the report concludes that a pattern exists of upward reestimates for discretionary programs and of downward reestimates for mandatory programs, which it interprets as implying that subsidy rates for discretionary programs are being deliberately understated. We disagree that such a pattern exists, and in fact, the data offered to support this conclusion have no systematic pattern. For both types of programs, the reestimates were split roughly 50-50 between upward and downward reestimates, and the number of observations was small. Indeed, a change for one cohort in each category would have reversed the report's finding. In addition, the reestimate data used in the report include the effect of interest rate changes, which are beyond the control of agencies, so it would be inaccurate to attribute these changes to attempts to deliberately understate subsidy rates. Furthermore, there is no reason to focus, as the report does, on just the first reestimate. A sounder approach would be to analyze all default/technical reestimates for each cohort to see whether they reveal a trend. Not enough years are yet available to perform this kind of test. As the report observes, "re-estimates generally fluctuated both up and down" (page 22). For these reasons, the report should state that the evidence does not demonstrate that subsidy rates for discretionary programs are being deliberately understated.

See comment 6.

Now on p. 17.

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Comments From the Office of Management
and Budget**

See comment 7.

Thirdly, we are concerned that the discussion of the timing of reestimates could lead to the incorrect assumption that subsidy rates for new loans are not being informed by the experience on existing loan cohorts. Ideally, all credit agencies would do reestimates shortly after the close of the fiscal year. In practice, this is not always possible. This time of year is a peak period of demand on agencies' resources, because they are simultaneously closing out the just-completed fiscal year, beginning to execute the current fiscal year, and preparing the President's budget for the subsequent fiscal year. OMB has therefore allowed some agencies to calculate reestimates later in the year, after the budget is submitted. This decision recognizes that there is a tradeoff between timeliness and accuracy. We believe that the additional time allows agencies to do better analysis of past performance, resulting in higher quality and more useful reestimates. These reestimates are then used to improve the accuracy of the subsidy rates that are estimated for the next budget.

See comment 8.

Fourth, it would be useful for the report to say more about how far subsidy estimation has improved since credit reform was first implemented. Estimating subsidy rates is inherently complex, and the availability of reliable information about loan performance is critical for accurately assessing risk. At the start of credit reform, few agency personnel had the training or expertise to calculate subsidy rates, and reliable financial data was often unavailable. In addition, a whole new system for budgeting had to be created within a few weeks between the time the FCRA was enacted and the preparation of the President's 1992 budget. Given those circumstances, it should be expected that the initial subsidy rates would be subject to relatively greater error, and that estimates would improve over time as agencies acquired experience and as financial systems improved. The report observes that "some progress is being made" and that "the availability of documentation has improved somewhat." GAO might put this development in context for the present report and consider it more completely either in this report or in a future report.

See comment 9.
Now on p. 24.

Finally, the report states that "Greater sustained commitment" by OMB is needed to implement credit reform fully (page 31). We hope that GAO recognizes the sustained commitment that has already been made by OMB. OMB employs three Budget Review Division staff members whose time is fully devoted to credit reform implementation and oversight issues, as well as a number of other BRD staff members who devote time -- sometimes very substantial time -- to credit issues on an as-needed basis. In addition, each credit program has at least one OMB examiner who is responsible for oversight. OMB works extensively with agencies every year, holds training classes, and has developed the model and user's guide used to estimate subsidy cost. It has helped to develop accounting standards for credit, and has committed considerable amounts of time to the interagency groups organized to improve the budgeting, accounting, and auditing of credit programs: the CFO Council Credit Reform Committee and the Credit Subgroup of the Governmentwide Audited Statements Task Force (both now combined in the Credit Reform Task Force of the AAPC). Therefore, we suggest that the report urge "continued" commitment by OMB.

Appendix IV
Comments From the Office of Management
and Budget

See comment 10.

In addition to these general observations, we have several specific comments, which are included as an attachment.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry Anderson", with a long horizontal flourish extending to the right.

Barry Anderson
Assistant Director for Budget

The following are GAO's comments on the Office of Management and Budget's March 11, 1998, letter.

GAO Comments

1. See "Agency Comments and Our Evaluation" section of the report.
2. We did not draw conclusions about the accuracy of subsidy rates from our observation that subsidy rates have fluctuated over time. Our report stated that the reliability of credit data was questionable for a number of reasons. Our characterization of the data was based primarily on results of the audits of the fiscal year 1996 financial statements as well as some discrepancies we identified between rates provided to us by agencies and those reported in the President's Budget.
3. The report does not propose a causal relationship between reestimates and subsidy rate fluctuations. Further, changes in assumptions cause the subsidy rate for a cohort of loans to fluctuate from year to year, not reestimates.
4. We did not assess whether any assumptions used in subsidy rate estimation were accurate. Further, we did not draw conclusions about a program from the size or direction of subsidy reestimates. We acknowledged that the fluctuations in subsidy rates could be due to credit extended at different interest rates than anticipated or to unanticipated changes in the economy, as well as other factors. We clarified the report language to state that interest rate changes are an example of such unanticipated economic changes.
5. Report text revised to clarify that the patterns are similar.
6. We compared the subsidy rate estimated for budget execution against the first subsidy reestimate for the following reasons. First, we used budget execution (rather than budget request) because it eliminated the effect of interest rate changes in the months between when the budget request rate was formulated and the time the government is obligated or committed for the loans. Second, credit reform guidance requires agencies to have appropriations of budget authority to cover the full estimated net present value cost of outstanding credit. Third, we used the first reestimate because if an agency sought to benefit from initially underestimating subsidy costs and there was oversight by OMB to ensure that agencies have sufficient appropriations of budget authority, the

agency would have to obtain budget authority to cover the shortfall as soon as possible—that is, in the first reestimate.

7. Given that three of the five agencies received waivers of the reestimate requirement, it would appear that their budget formulation is not being informed by the most recent experience on existing loan cohorts. The Credit Task Force of the Accounting and Auditing Policy Committee, which includes OMB and GAO representation, proposed that agencies that have OMB approval be allowed to use a combination of actual and projected data as the basis for reestimates. By allowing agencies to begin the reestimation process earlier, this approach should reduce the need for waivers—permitting agencies to use more recent actual data to inform budget formulation and to include them in the President’s Budget and financial statement audits.

8. We agree that this would be useful information. However, we could not obtain sufficient component data from agencies to evaluate whether subsidy estimation has improved over time, as indicated by smaller annual changes in reestimates due to technical factors. Our report does include a section discussing a number of recent efforts to clarify and simplify implementation of the Credit Reform Act. In other ongoing work, we are evaluating data reliability, barriers to credit reform implementation, and agency plans to overcome those barriers. We will also report on notable best practices in credit agencies as appropriate.

9. We do not dispute that OMB staff devote a substantial amount of time to credit issues. However, our conclusion that greater sustained commitment is needed reflects our concerns about the availability and reliability of credit data despite the fact that agencies now have prepared eight budgets since credit reform became effective for fiscal year 1992. Further, component data were not used to inform program management or budget decision-making.

10. OMB’s attachment containing specific comments has not been included, but our report has been modified as appropriate to reflect the comments contained in the attachment.

Comments From the Department of Agriculture

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



United States
Department of
Agriculture

Farm and Foreign
Agricultural
Services

Farm Service
Agency

1400 Independence
Ave, SW
Stop 0575
Washington, DC
20250-0575

MAR 11 1998

Mr. Gene L. Dodaro
Assistant Comptroller General
General Accounting Office
Washington, D.C. 20548

Dear Mr. Dodaro:

Enclosed is the Farm Service Agency response on the draft audit report. As you requested, we coordinated our response with the Rural Development mission area.

If we can be of any further assistance on the response to this draft report, please contact Craig Ahlberg, Chief, Farm Credit and Conservation Programs Branch at 720-9596.

Sincerely,

KEITH KELLY

Keith Kelly
Administrator

Enclosure



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Appendix V
Comments From the Department of
Agriculture

Response of Farm Service Agency (FSA) to issues raised in General Accounting Office (GAO) Audit Credit Reform: Greater Effort Needed To Overcome Persistent Cost Estimation Problems.

FSA's Budget Division has shared the GAO report with relevant offices within FSA and with the Rural Development mission area. We believe that the comments and suggestions of GAO will improve budget formulation and accounting for programs required to operate under credit reform procedures. We would like to note that FSA is doing considerable work to directly address GAO concerns noted in their report. FSA representatives have served on the Credit Task Force of the Accounting and Auditing Policy Committee, mentioned in the GAO audit, along with representatives of the Office of Management and Budget (OMB), the Department of the Treasury, the General Accounting Office, the USDA Office of Inspector General, and others. The result of these task force meetings was the development of an issue paper addressing Credit Reform's methods and documentation and an interim approach to meeting Credit Reform requirements.

FSA, along with the Rural Development mission area and in cooperation with the Chief Financial Officer of USDA, contracted in FY 1997 with the National Agricultural Statistics Service (NASS) to enhance the procedures used in preparing subsidy reestimates. This work is being finalized during FY 1998. In particular, NASS has completed a detailed analysis of the spreadsheets used by FSA to prepare subsidy reestimates. Improvements in the spreadsheets have been made that enhance their accuracy and improve the budget formulation process. The policy of preparing reestimates based on new historical actual loan data has been enhanced. With the assistance of NASS, the model used by FSA to prepare cash flow information is now secured to insure that data cannot be corrupted, will handle input data from actual loans as well as other relevant data, and is linked to provide the information requested by OMB for their subsidy model. We feel these enhancements on how we formulate credit reform budgets address many of the issues raised by the GAO in their report.

The NASS work in FY 1998 will include a redesign of the cash flow spreadsheet used by FSA budget analysts to maintain input data and model results outside the modeling structure of the spreadsheet. This would mean that estimates could be maintained electronically without annually rekeying cohort-specific input data.

Also, FSA is a pilot agency for the "balances approach" to preparing subsidy reestimates, sponsored by OMB. FSA will join the Department of Housing and Urban Development, mentioned in the GAO report, and perhaps other agencies as pilots. The first attempt to use this approach will be with reestimates prepared in FY 1998.

USDA programs, using credit reform budgeting, are much more extensive than those of many other Federal agencies. For instance, the FSA farm loan program portfolio

2

consists of approximately 60 cohorts in 8 distinct loan programs. We also have a multitude of servicing actions which create an extremely complicated accounting system. This means that yearly gains by USDA in improving credit reform budgeting and accounting can represent a significant accomplishment. FSA will continue to address the primary GAO concern regarding the documentation of technical assumptions through its planned developmental work.

The review of the GAO draft report by staff in the Rural Development mission area produced the following recommendation:

Replace on page 53, second paragraph with the following:

For figure II.2, Agency staff attributed the relatively large drop in subsidy rates, as reestimated between fiscal year 1995 and execution fiscal year 1996, primarily to the decrease in Treasury discount interest rates and the increase in borrower interest rates. The increase in borrower interest rates is due to a change in the RHS regulations in fiscal year 1996 which reduced the payment assistance to borrowers.

See comment 1.
Now on p. 46.

Appendix V
Comments From the Department of
Agriculture

The following are GAO's comments on the Department of Agriculture's March 11, 1998, letter.

GAO Comments

1. Report text was revised to reflect the agency's comment.

Comments From the Department of Education

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE UNDER SECRETARY

1998 5 1998

Gene L. Dodaro
Assistant Comptroller General
United States General Accounting Office
Washington, DC 20548

Dear Mr. Dodaro:

Thank you for the opportunity to respond to your draft report entitled "Credit Reform: Greater Effort Needed to Overcome Persistent Cost Estimation Problems."

We strongly agree with the report's emphasis on the importance of the Federal Credit Reform Act of 1990. Over the past five years, the Department of Education has steadily increased staff, contractor, and system resources dedicated to developing accurate and timely credit reform estimates for the government-guaranteed Federal Family Education Loan (FFEL) and William D. Ford Direct Student Loan programs. Within the Department's Budget Service, a Cost Estimation and Analysis Division has been established to focus on designing and refining cost projection models, analyzing program data, and preparing estimates. This unit works closely with the Office of Management and Budget (OMB) to make continuous improvements in the Department's credit reform estimates, models, and data sources.

The Budget Service has also opened up its estimates to outside discussion and peer review. For example, the Department regularly reviews its student loan budget estimates and underlying assumptions with an external technical group including representatives from the Congressional Budget Office, the Treasury Department, the Congressional Research Service, the General Accounting Office (GAO), congressional committee staff, Sallie Mae, guaranty agencies, and associations interested in and knowledgeable about higher education costs and borrowing behavior. This group is one of a number of efforts undertaken by the Department to improve understanding of the technical aspects of the budget process and enhance the accuracy and usefulness of our cost estimates.

The Department's Office of the Chief Financial Officer and Chief Information Officer, as well as the Office of Postsecondary Education, have also dedicated significant staff resources to collecting, analyzing, and improving credit reform data, with a particular focus on addressing data quality and liability estimate concerns raised by independent auditors in their review of the Department's financial statements and by previous GAO reports.

While concurring with the overall thrust of the report, we want to raise a question about the implication that significant shifts in subsidy re-estimates over time are necessarily a bad thing. Credit reform has forced agencies, in many cases for the first time, to develop, analyze, and refine detailed data on the behavior of borrowers, lenders, and other loan program participants over the 15- to 40-year life of a loan cohort. One result of this costly and complex process is the

600 INDEPENDENCE AVE., S.W. WASHINGTON, D.C. 20202

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

See comment 1.

**Appendix VI
Comments From the Department of
Education**

Page 2 - Gene L. Dodaro

development of improved assumptions in a range of areas, such as projected default or collection rates, that can dramatically change program cost estimates. In addition, as the report notes, shifts in economic factors such as interest rates can also significantly affect program costs, as can legislative or regulatory changes. Acknowledging the impact of these changes, as well as of improved data, through regular re-estimates is not a problem; indeed, it is one of the principal benefits of credit reform.

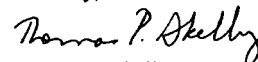
See comment 2.

On another point, the report notes that the Department of Education uses the OMB credit subsidy model at a different point in the estimation process than other agencies. As a result, the report indicates it did not have documentation for the Department's subsidy rates. To clarify, the Department, with the participation and approval of OMB, has developed a sophisticated subsidy cost estimation methodology that makes minor adjustments to subsidy rates produced by the OMB model. This methodology is fully consistent with the requirements of the Federal Credit Reform Act and was thoroughly explained and documented for GAO staff gathering data for this report. At that time, the Department provided all supporting materials requested by GAO. We would be happy to discuss these materials, or provide additional information, at GAO's request.

See comment 3.

We appreciate the opportunity to comment on the draft report. If you have any questions regarding our comments, please feel free to contact me or my staff.

Sincerely,



Thomas P. Skelly
Director, Budget Service

The following are GAO's comments on the Department of Education's March 5, 1998, letter.

GAO Comments

1. See "Agency Comments and Our Evaluation" section of the report.
2. The report text was clarified to reflect Education's comment.
3. Education provided all total subsidy rate estimates we requested but did not provide subsidy components for each of these rates. Moreover, although Education explained why the requested documentation—OMB model output—would not be helpful, it did not provide alternative supporting documentation.

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

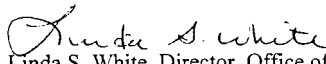


U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000

March 4, 1998

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MEMORANDUM FOR: Owen M. Jones, Assistant Deputy Chief Financial Officer

FROM: 
Linda S. White, Director, Office of Housing Budget and Field Resources

SUBJECT: Comments on Draft GAO Report Entitled "Credit Reform: Greater Effort to Overcome Persistent Costs Estimation Problems"

We appreciate the opportunity to comment on GAO's Draft Report. At the request of the Senate Budget Committee Chairman, GAO conducted a review to determine (1) whether agencies completed estimates and re-estimates of subsidy cost; (2) whether any trends could be readily discerned including improvements in subsidy estimates; (3) whether the causes for changes in subsidy estimates could be readily identified; and (4) whether agencies with discretionary programs initially-underestimated credit subsidy costs in response to the incentive created by the availability of permanent, indefinite budget authority for credit re-estimates.

HUD was one of five agencies reviewed by GAO for this Report. As to the questions examined in the Report, HUD has both experienced some problems and made significant progress since the Credit Reform Act of 1990 was enacted.

Subsidy Cost Estimates and Re-estimates: HUD has produced subsidy estimates each year in the Budget for the two programs reviewed. As the Report notes, HUD has received waivers for the development of subsidy re-estimates from time to time during that period. The Report does not explain why subsidy re-estimates need to be waived. The re-estimates, in theory, are to be submitted by the agency, together with the Budget year estimates, in time for the President's annual budget submission to the Congress. The results across agency lines indicate that HUD's situation in this respect is not unique. The resources required: (1) for accounting staff to prepare actual data by risk category by cohort; (2) for the actuarial analysis of conditional claim rates and conditional prepayment rates to be developed (in the case of the Mutual Mortgage Insurance Fund); and (3) for the Budget staff to manually update hundreds of credit files for input into the OMB subsidy model during the October-December time frame is unrealistic. For HUD, a choice has to be made between developing the Budget submission or developing subsidy re-estimates. Delaying the subsidy re-estimates until the summer season represents a more realistically achievable workload. OMB has recognized this practical limitation and is working to make the re-estimate process easier for all agencies. The "balances" approach may provide a less work intensive methodology for addressing the timeliness of the subsidy re-estimates.

See comment 1.

Trends in Subsidy Estimates, including Improvements: The Report notes (Page 11) that progress in subsidy estimation is being made at each of the agencies, including HUD. HUD is working to improve the actual accounting data and the economic analysis supporting the cash flow projections which serve as the basis for subsidy estimates. HUD retained Price Waterhouse to review and improve subsidy rate calculations for several risk categories. HUD is keenly aware that supportable cash flow projections are critically important in making the estimates meaningful in any sense. This includes both maintaining actual cohort accounting data over the years (an increasingly burdensome task as the years go by and the number of risk categories and cohorts expands) as well as updating and refining expectations about the future. The GAO Report (Page 22) notes that: "...total subsidy estimates within a given cohort often varied widely over time. Moreover, estimates for different cohorts within the same program also differed widely. These sharp variations raise questions about the causes for these changes and the reliability of the underlying data."

See comment 2.

The Report speculates that over time some fluctuation in subsidy rates would be expected due to : (1) loans or guarantees made at different interest rates than anticipated; (2) programmatic re-design; better information on technical factors such as defaults, prepayments and fees from actual experience; and, (3)) unanticipated changes in the economy. The Report further speculates that, given experience, over time the annual changes in re-estimates due to technical factors would be smaller. Given the absence of this expected pattern over time, the Report infers that something is wrong with the data —"These sharp variations raise questions about the causes for these changes and the reliability of the underlying data."

HUD staff disagrees with GAO's inference that the "expected" amount of variation in subsidy rates will diminish over time. An equally compelling case might be made that better data will result in greater levels of variation in year to year re-estimates. While HUD does not dispute that agencies can do a better job at making sure the actual data is the best that it can be, we would maintain that the actual data is reflective to a large degree of what is going on in the credit programs. We are making progress toward better data and the process of subsidy estimation refinement will continue at HUD. However, it is unclear at what point GAO believes we should rely on the results of analysis supported by the actual data. The acceptable measure of reliability for subsidy estimation purposes is also unclear.

See comment 3.

The variability phenomenon noted by the GAO Report is evidence that the difficulty in estimating lies not in the accuracy, reliability, timeliness or documentation of data used in the OMB subsidy model but in the credit reform methodology itself. We are concerned that data quality issues are masking more fundamental limitations with Credit Reform analysis. The results, as GAO notes, are not consistent. And that, in fact, may be the best that Net Present Value (NPV) analysis, and the ongoing re-estimate of original calculations, can ever achieve no matter how good or timely the data. There are inherent limitations of NPV analysis as applied over the long term to cost estimation.

Causes for change : The Report includes anecdotal evidence that there are particular factors which influence each credit program in fairly unique ways. That is to be expected. What is common to all the variation in rates is that the future cannot be predicted with any certainty. Variability will occur regardless of how good or timely the data or how efficiently the OMB subsidy model is executed. The Report (Pages 5 and 6) notes that:

“The development of credit reform requirements reflects in part decision makers’ interest in analyzing the causes of changes in subsidy estimates. Understanding which of the components of subsidy expense – interest, net defaults, fees and other collections, and other subsidy costs—are the key drivers of re-estimates and yield insights into program operations...Preparing subsidy estimates is complex for a number of reasons. These include projecting cash flows many years into the future and assessing the effect of economic changes on a particular program and its borrowers.”

GAO highlighted one of the most fundamental limitations of the Credit Reform methodology. Causes for change cannot be readily identified. Attempts can be made to explain the forces that caused actual claims, actual interest rates or other actual costs to vary from the original assumptions, although this is not an easy task in most instances. But projecting reasonable assumptions about future cash flows is problematic. No amount of additional guidelines for documenting subsidy components, for developing and maintaining accurate and timely actual data, or for improving execution of the OMB subsidy model will serve to produce a clearer picture of future cash flows.

Whether Agencies Initially Underestimated Discretionary Credit Subsidy Estimates as a Result of the Availability of Permanent, Indefinite Budget Authority for Subsequent Re-Estimates: GAO states that 8 of 15 discretionary cohorts increased in the first re-estimate following the initial appropriation. That means 7 of 15 did not increase. Similarly, 7 of 12 mandatory cohorts decreased while 5 cohorts stayed the same or increased. GAO concludes that : “It may be difficult to determine whether agencies intentionally under-estimated subsidy costs in initial estimates given the data unreliability and the number of other factors (such as changes in interest rates or other economic conditions) that could affect subsidy estimates and re-estimates.” It appears that GAO is discounting its own results because they do not meet a preconceived expectation. GAO seems to be drawing the inference that the results are inconclusive because of the unreliability of data and economic forecasting. But another interpretation is that this is exactly the result one might expect to see. About half the re-estimates are up and half are down. HUD’s experience has been that, for the most part, downward adjustments were required from the initial estimates. The subsidy rate review process is rigorous both internally in HUD and at OMB. It is unlikely that agencies could intentionally underestimate credit subsidy estimates.

Conclusion: This Report documents the difficulty virtually every credit agency is experiencing in dealing with the reporting and budget estimating requirements of the Federal Credit Reform Act of 1990. They include: (1) problems in redesigning financial and accounting systems to develop timely and reliable input data into the OMB subsidy model; (2) problems in

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Comments From the Department of Housing
and Urban Development

4

calculating re-estimates of prior year cohorts in time for submission with the President's budget; and (3) establishing guidelines and maintaining documentation of credit subsidy estimates for audit purposes. HUD staff are committed to making improvements where possible.

See comment 3.

But the Report does not address the fundamental implications of its own results. We disagree with the premise of the title of this Report : Greater Effort Needed to Overcome Persistent Cost Estimation Problems. We believe that the problems with the cost estimates have less to do with the level of effort to perfect data collection and the timeliness of re-estimates than it has to do with the inherent limitations of the NPV technique in the practice of cost estimation.

We are hopeful that a realistic look at GAO's data in this Report might serve to begin a fundamental reassessment of the effectiveness of the Credit Reform methodology. We have committed Federal Credit agencies, and substantial Federal dollars, to supporting a cost estimation technique that is producing results which are of questionable reliability. Credit Reform was the starting point for addressing the government's subsidy costs for federal direct loans and loan guarantees and to permit better cost comparisons both among credit programs and between credit and non-credit programs. The GAO Report has, in essence, highlighted the limitations of the Credit Reform methodology.

See comment 6.

Attached is a listing of comments/corrections for specific pages of the Report.

Again, I would like to express our appreciation for the opportunity to comment on the GAO Report and hope that our remarks provide assistance in achieving our common goal of improving cost estimates.

Attachments

The following are GAO's comments on the Department of Housing and Urban Development's March 4, 1998, letter.

GAO Comments

1. An explanation of agencies' reported need for waivers has been added to the report.
2. The report was clarified to specify that agencies can improve their ability to forecast defaults, recoveries, prepayments, and fee revenue through better modeling and more and better historical data.
3. Our report acknowledges the implementation difficulties involved with credit reform. However, once agencies establish a systematic approach to subsidy estimation based on auditable assumptions, present-value-based budgeting for credit will provide significantly better information than the former cash-based system.
4. Our statement that causes for changes in estimates cannot readily be identified was based on the fact that much of the component data that would point to causes for such changes was missing, inaccurate, or inconsistent with other data reported by agencies.
5. We clarified the report to indicate that the patterns were similar and that the data were inconclusive. As the report states, any firm conclusion about the reasons for changes in reestimates would require better data and more in-depth study.
6. HUD's attachment containing technical comments/corrections has not been included, but our report has been modified as appropriate to reflect the comments contained in the attachment.

Comments From the Small Business Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

March 5, 1998

Mr. Gene Dodaro, Assistant Comptroller General
United States General Accounting Office
Accounting and Information Management Division
Washington, D.C. 20548

RE: Draft Report on Credit Reform

Dear Mr. Dodaro,

Thank you for the opportunity to respond to the draft report listed above prepared by your agency.

Our most significant concern is the quotation on page 26 which suggests that subsidy rates are manipulated. This quotation is from an internal SBA study. The statement was incorrect then and is incorrect now. Due to the special nature of the report, it was not circulated within SBA for comment, correction and refinement. We would be very surprised if GAO auditors encountered any information to support this statement. Rather, your staff must have observed the quality of our data and our staff in addition to the SBA's commitment from the Administrator to the analyst to have accurate and credible subsidy rates. If, in your work, you discovered any support for the statement in question, please make that available to us. SBA's subsidy rates are prepared based on historical information and are reviewed by OMB as well as reliable consultants with an in-depth knowledge of the process and represent our best estimate of the expected cost of the program.

As your report states, SBA has made a substantial commitment to comply with FCRA by producing accurate subsidy estimates and re-estimates. The report ignores the strengths of our program, relative to other agencies. These strengths include the availability of accurate accounting data as evidenced by our second unqualified audit, better conclusions based on historical data rather than assumptions of how our programs perform, and the use of more sophisticated analytical techniques to derive conclusions on performance. Our interaction with the Federal Credit Policy Working Group and OMB indicates that because of these strengths, our practices represent the leading edge of compliance with FCRA. If you agree, we would appreciate your acknowledgment of this position within your report.

Our general comments are as follows:

1. The report focuses on general results and shortcomings of the process for credit agencies in the aggregate. It would be extremely helpful if specific examples or causes were noted so that they can be addressed by each agency.
2. Since more specific citations are often not made, one agency's problems may be perceived to apply to all or several of the other agencies.
3. Your report should give more emphasis to the importance of changes in economic conditions when discussing variations in subsidy rates. While national interest rates are important to direct loan programs with subsidized interest rates, regional and national economic conditions (such as employment growth, real estate valuations, and industrial mix) are also significant factors contributing to the changes in default rates. They are also the least predictable and the least used in models within the federal credit agencies. This is one of the reasons SBA has embarked on an econometric analysis project.

See comment 1.
Now on pp. 19-20.

See comment 2.

See comment 3.

See comment 4.

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Comments From the Small Business
Administration

See comment 5.

4. SBA spent considerable time and effort during FY 1997 in reviewing and upgrading the subsidy models, documentation and our management process for the FY 1999 budget submission. During 1997, SBA contracted with three consulting firms to validate the results of the FY 1998 models, determine the reasons for the data problems that had been previously identified and review our modeling methods and provide input on how SBA could improve our data collection and analysis. Also, SBA contracted with consultants regarding internal controls, documentation, and management practices. During 1997, we incorporated a significant number of their recommendations into our processes. This demonstrates a considerable commitment on the part of SBA's management and technical staff which should be mentioned in your report.

See comment 6.

5. SBA met on several occasions with your staff auditors in February to discuss barriers to Credit Reform implementation. The draft report does not sufficiently highlight these meetings. We would suggest a section focusing on these issues from the staff and managerial level.

See comment 7.

6. Analytical methods differ by agency and sometimes program. A background discussion of modeling methods among agencies would be helpful in the report for the reader to understand the underlying concepts and complex deliberations in producing subsidy rates.

With regard to specific items contained in the report, please note the following:

See comment 8.
Now on p. 2.

1. On page 3, your report notes that "Accounting Standards for credit programs were developed to be consistent with the intent of this act." Your report does not state whether these standards are adequate and whether agencies can adequately comply with these standards given the age of the standards themselves.

See comment 9.
Now on p. 3.

2. On page 4, your report notes that "The Balanced Budget Act of 1997 amended the federal Credit Reform Act to simplify and clarify subsidy estimation requirements." No specifics are given as to how this was to occur.

See comment 10.

3. On page 8, your report notes that SBA's Disaster Loan program was not re-estimated for the budget or financial statement audits during this period. This comment is unnecessarily repeated several times in the report (also on pages 15 and 19). This re-estimate was not performed, with the concurrence of OMB and the knowledge of SBA's auditors as there were some anomalies in the data which would have produced inaccurate results. We would appreciate your clarifying this issue. We would suggest that you emphasize the fact that a re-estimate was made for the 1999 budget. While this statement is found in the body of the report, the Executive Summary fails to state this.

See comment 11.
Now on p. 6.

4. On page 8, your report notes that agencies with loan guarantee programs rely on guaranty agencies for loan performance data. We feel you should define the term, guaranty agency, as it appears to be different than the agency which actually provides the guarantee. We think that you mean a lender or intermediary.

See comment 12.
Now on p. 8.

5. On page 10, your report notes that "meaningful component data were not available to be used internally or by OMB for budget formulation." We feel that a conclusion of this nature needs to be supported by showing the name and number of programs to which this applies.

See comment 13.

6. In the Recommendations section, we would suggest that the report provide more specific recommendations as to data collection and analysis, oversight by OMB, and documentation. This will enable our agency to further target specific processes for improvement.

See comment 14.
Now on p. 9.

7. On page 12, your report notes that you found problems with underlying accounting data. We feel that this needs to have specific support. Also on that page, you note that Agencies

**Appendix VIII
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See comment 15.

See comment 16.
Now on p. 10.

See comment 17.
Now on p. 10.

confirmed rates different from the budget in numerous instances. However, you fail to cite the cause as poor document retention practices which we believe is the underlying cause.

8. On page 13, you state that you did not prepare a graph for SBA's Disaster Loan program due to the lack of data and information. However, we feel that you could have prepared a graph similar to the other pages as all of the execution rates were available.
9. Page 14 contains a headline stating "Problems Persist with Agencies' Estimates of Subsidy Cost." This section needs more specific support to be meaningful.

We appreciate the opportunity to make comments on this draft. Should you have any questions, please do not hesitate to contact our office.

Sincerely,


Larry Wilson
Chief Financial Officer

JLW/fjr

The following are GAO's comments on the Small Business Administration's March 5, 1998, letter.

GAO Comments

1. See "Agency Comments and Our Evaluation" section of the report. The report text also was clarified to reflect SBA's position and our evaluation.
2. See "Agency Comments and Our Evaluation" section of the report.
3. Data specific to individual agencies are shown in tables contained in appendix III. In other ongoing work, we are evaluating data reliability, barriers to credit reform implementation, and agency plans to overcome those barriers. We also will report on notable best practices in credit agencies as appropriate.
4. Throughout our report, we cite changes in economic conditions and/or interest rates as the first item in a list of possible causes of changes in subsidy rates, thus emphasizing their importance.
5. See "Agency Comments and Our Evaluation" section of the report.
6. See comment 3. The results of the February 1998 meetings will be considered in a future report on this work.
7. While a comparison of modeling methodologies used by the five credit agencies would be interesting, it is outside the scope of this report.
8. A review of the adequacy of accounting standards and budget guidance was outside the scope of this report. However, in other ongoing work, we are evaluating barriers to credit reform implementation and agency plans to overcome those barriers. The adequacy of accounting standards and budget guidance, if identified as barriers, would be considered in that work. Further, as we noted in our report, changes to accounting standards and budget guidance for credit programs are being considered.
9. A brief discussion of these changes is contained in appendix I.
10. Recognition that SBA reestimated the Disaster Loan Program for the fiscal year 1999 budget was added to the "Results in Brief" section.
11. The report text was revised as suggested.

12. Appendix III includes tables by agency and program that illustrate where component data were unavailable.

13. Our report does address oversight by OMB. The Subgroup on Credit Reform of the Government-wide Audited Financial Statements Task Force (now the Credit Task Force of the Accounting and Auditing Policy Committee) has been working on data collection, analysis, and documentation issues for several years and has proposed guidance.

14. Recent financial statement audit reports cited in our report text have raised questions about data reliability. Our report also describes discrepancies between data in the President's Budget and data provided and confirmed by agencies.

15. We agree that poor document retention is one cause of differences between agency-confirmed rates and those reported in the President's Budget.

16. The data provided by SBA does not permit us to prepare graphs similar to other programs. We graphed estimated subsidy rates from two perspectives. The first graph (for example, see figure II.12) showed the most recently estimated total subsidy rate for each year's cohort of credit—the rates for all of the outstanding cohorts were calculated and based on historical and economic data updated as of the same point in time. Using the budget execution rates as suggested by SBA would not be a similar approach because the rates were calculated at different points in time. The second graph (for example, see figure II.13) showed the estimated and reestimated subsidy rates for a given cohort over time beginning with budget execution. It would not be possible to do this for the Disaster Loan Program since SBA provided only the initial rate graphed in this analysis.

17. Specific support exists on pp. 10 through 16.

Comments From the Department of Veterans Affairs

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF VETERANS AFFAIRS
Veterans Benefits Administration
Washington DC 20420

MAR 11 1998

In Reply Refer To:

Mr. Gene L. Dodaro
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

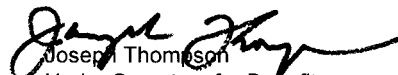
Dear Mr. Dodaro:

Enclosed are our comments on the draft GAO report entitled CREDIT REFORM: Greater Effort Needed to Overcome Persistent Cost Estimation Problems.

VA agrees with your recommendations and offers the enclosed comments. These comments are offered to clarify certain issues and data in the report and to assist the Chairman, Committee on the Budget, U.S. Senate in acquiring a more detailed insight into the budget complexities of VA Housing Programs.

Thank you for the opportunity to provide comments on behalf of the Department of Veterans Affairs.

Sincerely yours,


Joseph Thompson
Under Secretary for Benefits

Enclosure

**VA's Comments on GAO Draft Report
CREDIT REFORM: Greater Effort Needed to Overcome Persistent Cost Estimation
Problems**

The following comments on the draft report are provided to assist the Chairman, Committee on the Budget, United States Senate, to acquire a more detailed insight into the budget complexities of VA Housing programs.

Although this report generally addresses credit estimating procedures across five major credit agencies, VA offers these comments and recommendations to clarify VA's implementation of credit program estimating procedures.

The most difficult part of estimating under credit reform is the development and maintenance of the many complex cashflow models. The original development of VA's cashflow models was a joint effort between VA and OMB. Much like Credit Reform, these models have evolved over the years and continue to be updated due to changes in law, assumptions, modeling methodologies, program experience and official guidance and processes.

VA Housing Program budget estimates are prepared by the Veterans Benefits Administration (VBA), Office of Resource Management (ORM) and provided to the requesting organization through the Department's Budget Service. Supporting information is provided in hard copy and electronic form unless otherwise specified. As requested, this information is also provided to the VA Office of the Inspector General and several outside organizations, e.g., CBO, GAO.

VBA budget staff works closely with Loan Guaranty Service program experts and Department budget staff throughout the budget cycle in the formulation of all budget estimates (Internal, OMB, and President's), legislative analyses, monitoring of current budget limitations and program activity.

The formulation of credit program estimates is a complex effort and requires much coordination between VBA program experts, ORM Budget and Finance staffs, and the Department Budget Service. VA is fortunate that the primary individuals from each of these areas have been involved with the Housing program since the beginning of Credit Reform. The recent consolidation of the Housing accounts reduced the number of accounts involved and will gradually enhance budget coordination efforts. The reduction from eleven accounts to four reduces the workload associated with estimating and reporting efforts regarding the Housing program. This will allow more time for analysis of budget cashflow models, financial and program data, and budgetary assumptions, thus improving budget projections.

Page 7 of the draft states, "none of the programs in the study had for GAO review all of the required budget request, budget execution, and re-estimate subsidy rates and supporting documentation for fiscal years 1992 through 1998." VA provided copies of

all subsidy cashflow estimates to GAO, including associated cohort financial and workload data. Electronic copies of all subsidy cashflow estimates were available for analysis and verification upon request. It is important to recognize that credit reform and its expectations have slowly evolved since 1992. The early years of credit reform implementation should not be held to current standards and expectations of cashflow modeling methodologies, estimating, data documentation, and guidance.

Table 1, page 17, displays the years in which VA did not provide backup documentation. For these years, the only missing documentation was the printed output page from the OMB Credit Subsidy Model. As previously mentioned, VA's cashflow models were developed together with OMB staff. In 1992, these models originally included a present value calculator designed and installed by OMB. This calculator automatically performed the required subsidy calculation within VA's cashflow models. At the time these estimates were made, VA complied with all estimating and documentation procedures. Under the direction of OMB, VA did not begin using the OMB subsidy calculation model until the 1994 budget cycle. Therefore, other than the cashflow data provided to GAO for 1992 and 1993 subsidy estimates, no other documentation exists. [VA recommends that Table 1 include a "✓" or appropriate footnote for both programs in the 1992 and 1993 columns.]

Beginning with the 1994 budget, all VA subsidy estimates were the product of the OMB subsidy calculator. VA was not able to provide the printed output page from the OMB calculator for the missing years shown in Table 1 because this backup data was neither required or requested during this stage of credit reform implementation. The OMB calculator does not print its results unless requested by the user. The calculator automatically displays the subsidy rate output on the user's monitor. As the backup was not required, this data was taken from the screen and incorporated into VA cashflow models. If requested, the printed output was produced and provided but was not required to be included in estimate backup documentation.

In 1993, OMB provided credit Agencies with the "OMB Subsidy Model Assistant." This is a Lotus spreadsheet designed to work in conjunction with the OMB subsidy calculator (Version r.7) to automate the calculation of subsidy rates via macros and import results directly into the cashflow files. This OMB Model Assistant was designed to make subsidy calculations easier for Credit Agencies by not having to leave the cashflow file to run the OMB Credit Subsidy Model separately. VA utilized the Subsidy Model Assistant to automatically calculate and import the subsidy rates directly into the cashflow files. This streamlined the subsidy calculation process and still, the printed output was not part of the required budgetary documentation at the time. [VA recommends that where missing data is indicated in Table 1 beginning in the 1994 column, footnotes be included for both programs (1994 through 1996 columns) stating that the OMB model was used to calculate all subsidy estimates.]

VBA provided paper and electronic copies of these budget files to the Department Budget Service and OMB for review. Several of the former OMB budget examiners

independently verified subsidy rates and performed sensitivity analyses, program estimates, etc., on a regular basis. It was not until the recent interest in reporting the individual components of subsidy rates in the financial statements that this backup data gained such importance.

All subsidy rates were calculated as directed and supervised by OMB. VA does not believe that the time necessary to recreate and download each of the cashflow files through the appropriate version of the OMB subsidy calculator for its printed output would add any value to this report.

Regarding the problems with data accuracy underlying the preparation of estimates and reestimates, we provide the following comments:

During the early years of Credit Reform, VA experienced many systems problems programming its 1960's and 1970's era legacy systems to implement cohort year accounting. While these problems continue to be addressed, the impact is evident in later reestimates of these earlier cohort years and the values of later cohort years' subsidy rates for the same fund. Technical reestimates were used to correct these early systems problems as actual cohort year data became available. VA considers this to be a normal transition effect associated with the very large changes required under Credit Reform.

In the early years of Credit Reform, financial data and estimation requirements were not always clear and were also subject to interpretation by the individual OMB examiner working with the VA. An example was the early requirement for accounting by tranches. While these requirements became clearer as OMB, Treasury and the credit agencies gained more experience in Credit Reform, guidance for the first several years produced varying results because data and estimates were not generated in the same way as in later years and even between agencies.

In 1994, VA offered veterans with loans guaranteed by VA a no-cost refinancing program. The refinanced loans (which became new Credit Reform loans in the year of modification) more than doubled VA's typical annual volume. The shift of cohort year data also caused additional accounting workload due to the interfund and inter-cohort reimbursement activity, still considered relatively new at this stage.

VA has undertaken a series of actions to improve its Credit Reform accounting to provide for more accurate data. These actions include:

- A. Contracting for an independent study for achieving financial compliance for its accounting systems. VA is waiting for the final report due March 1998 to develop its plans in this area.
- B. Redesigning its property inventory systems and related accounting functions to centralize payment and collection reporting and reduce manual input. Implementation is planned to begin in the 3rd quarter of 1998.

**Appendix IX
Comments From the Department of
Veterans Affairs**

- C. Redesigning its acquisitions and claims systems and related accounting functions to centralize payment and collection reporting and reduce manual input. Implementation is planned to begin in the 4th quarter of 1998.
- D. Contracting out the servicing of its portfolio home loans program, including accounting, and requiring the contractor to provide summary accounting data to VA monthly. Implementation began in 1997.
- E. Consolidating housing accounting and reporting activities, with potential to reduce to one central finance location. This will solve the problems created by having accounting generated at 50 separate accounting and reporting offices. Implementation began in 1996 and is on-going.

These actions, when fully implemented, should improve the reliability of data in the future.

Miscellaneous comments:

See comment 2.
Now on p. 7.

On page 9, first paragraph, the last sentence implies that the financial audit findings referred to are strictly VA findings. We suggest replacing the last sentence with "Financial statement audit findings from the Federal agencies we reviewed would lead us to conclude that at least some of the fluctuations are caused by weaknesses in agency data used to develop the cash flow estimates."

See comment 2.
Now on p. 16.

On page 21, footnote 23 makes reference to a GAO report on Year 2000 progress. We would recommend that GAO include in this report any current data applicable to correcting Year 2000 compliance for the Housing Credit Program systems.

See comment 2.
Now on p. 25.
See comment 3.
Now on p. 61.

Page 33, second paragraph should read, "In addition, the Director of OMB...."

Page 67, proper account titles for both graphs is Guaranty and Indemnity Fund Guaranteed Loan Financing Account.

See comment 2.
Now on pp. 84 and 86.

Change the first sentence of footnote "a" on pages 82 and 83 to read, "VA has consolidated its guaranteed loans into one account and its direct loans into another (Public Law 105-65)."

The following are GAO's comments on the Department of Veterans Affairs' March 11, 1998, letter.

GAO Comments

1. We revised table 1 to show that VA had provided all requested rates and documentation for fiscal years 1992 and 1993. We made the change for fiscal year 1992 because VA stated that the cash flows showing only 5 of the 15 years of the credit maturity represented all of the output created by the OMB/VA model for that year. For fiscal year 1993, VA provided only one of the four quarterly execution cash flows requested. However, we discussed VA's comments with VA staff who told us that they did not revise the cash flows for each of the four quarters of fiscal year 1993.
2. Report text was revised.
3. Account title was revised.

Major Contributors to This Report

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Related GAO Products

Veterans Affairs Computer Systems: Action Underway Yet Much Work Remains to Resolve Year 2000 Crisis ([GAO/T-AIMD-97-174](#), September 25, 1997).

Credit Reform: Review of OMB's Credit Subsidy Model ([GAO/AIMD-97-145](#), August 29, 1997).

Credit Subsidy Estimates for the Sections 7(a) and 504 Business Loan Programs ([GAO/T-RCED-97-197](#), July 15, 1997).

Debt Collection: Improved Reporting Needed on Billions of Dollars in Delinquent Debt and Agency Collection Performance ([GAO/AIMD-97-48](#), June 2, 1997).

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

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

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