Financial Policy

Volume VI

Liabilities

Chapter 6

Liabilities for Loan Guarantees

Approved:
Jon J. Rychalski
1367389
Digitally signed by
Jon J. Rychalski
Date: 2022.01.03
09:55:53 -05'00'

Jon J. Rychalski
Assistant Secretary for Management
and Chief Financial Officer
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0601 Overview

This chapter establishes the Department of Veterans Affairs’ (VA) financial policies regarding measuring, recognizing, re-estimating, and reporting of liabilities for loan guarantees. The Federal Credit Reform Act of 1990 (FCRA), effective October 1, 1991, divides VA’s loan guaranty commitments into two groups: those that were made before fiscal year 1992 (pre-1992) and those that were made in fiscal year 1992 and later (post-1991).

Key points covered in this chapter:
- VA will apply different accounting standards to pre-1992 and post 1991 guaranteed loans liabilities in accordance with the Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) 2, 18, and 19;
- VA will recognize a subsidy expense for guaranteed loans in the year of disbursement equal to the estimated present value of cash outflows over the life of the loan minus the present value of estimated cash inflows;
- VA will re-estimate the subsidy cost allowance yearly with any resulting adjustment recognized as subsidy expense (or a reduction in subsidy expense);
- VA will account for guaranteed loan modifications and sales, in accordance with FASAB, the Office of Management and Budget (OMB), Treasury, and VA’s guidance; and
- VA will, in accordance with OMB Circular A-136 (Financial Reporting Requirements), report guaranteed loan liability on the consolidated balance sheet and disclose required information in the accompanying notes.

0602 Revisions

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<td>Various</td>
<td>Reformatted to new policy format and completed comprehensive five-year review and update</td>
<td>OFP (047G)</td>
<td>Ensure policy is up to date with current laws and regulations and accurate</td>
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<td>0603 Definitions</td>
<td>Updated for clarity of understanding</td>
<td>OFP (047G)</td>
<td>Improve effectiveness and clarity of the policy</td>
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<td>0604 Roles and Responsibilities</td>
<td>Clarify responsibilities for measuring, recognizing, re-estimating, and reporting of the liability</td>
<td>OFP (047G)</td>
<td>Defines specific responsibilities for various positions and organizations responsible for guaranteed loan liabilities</td>
<td>December 2021</td>
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<td>0605 Policies</td>
<td>Updated policy statements to include Modeling Governance and Oversight standards</td>
<td>OFP (047G)</td>
<td>Properly reflect VA’s loan guarantee liability accounting and reporting requirements</td>
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<td>0606 Authorities and References and References</td>
<td>Added Auditing Technical Release 3 (Revised)</td>
<td>OFP (047G)</td>
<td>Enhanced support necessary for Home Loan Guaranty modeling</td>
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**0603 Definitions**

**Administrative Expenses** – Costs that are directly related to credit program operations, including payments to contractors.

**Cohort** – The direct loans obligated, or loan guarantees committed by a program in the same year even if disbursements occur in subsequent years.

**Credit Program** – A Federal program that provides loan guarantees to non-Federal entities, e.g., to segments of the population not adequately served by private lenders.

**Default** – The failure to meet any obligation or term of a credit agreement, grant, or contract.

**Discount Rate** – Treasury interest rates that are used to calculate the present value of the cash flows that are estimated over a period of years.

**Econometric Model** – A set of mathematical equations that depict real economic conditions both in the present and in the future. Econometric models are used to determine the economic effects of changes in government policy and regulation, changes in interest rates, tax law, population trends and many other factors.
Financing Account – A non-budget account associated with each Credit Program account. The financing account holds fund balances, receives the subsidy cost payment from the Credit Program account and includes all other cash flows to and from the Government resulting from post-1991 direct loans or loan guarantees, including Treasury borrowings.

Foreclosure – A legal proceeding instituted by a loan holder, where the failure of a borrower to repay the entirety of a secured debt results in the termination of the borrower’s rights in the property (and title to the property is transferred to the holder’s successor or assign).

Guaranteed Loan Sales Liabilities – The present value of the estimated cash flows to be paid by VA as a result of the guarantee.

Liabilities for Loan Guarantee – A probable future outflow or other sacrifice of resources as a result of VA’s Home Loan Guaranty program.

Liquidating Account – A budget account that records all cash flows to and from the U.S. Government resulting from pre-1992 direct loan obligations or loan guarantee commitments (unless they have been modified and transferred to a financing account).

Loan Guarantee – Any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender, but not including the insurance of deposits, shares, or other withdrawable accounts in financial institutions.

Loan Guarantee Commitment – A binding agreement by a Federal agency to guarantee a loan when specified conditions are fulfilled by the borrower, the lender or any other party to the guarantee agreement.

 Marketable Treasury Securities – Securities, including Treasury bills, notes, bonds, and Treasury Inflation-Protected Securities (TIPS), that Treasury initially issues for sale to the marketplace and that can be bought and sold on securities exchange markets.

Master Servicer – The servicing entity responsible for performing all of the loan servicing functions under the Pooling and Servicing Agreements created for each Vendee Mortgage Trust (VMT) sale.

Maturity or Maturity Date – Refers to the final payment date of a loan or other financial instrument, at which point the principal (and all remaining interest) is due to be paid.

Measurable – A value can be reasonably estimated.

Modification – A Government action that (1) differs from actions assumed in the baseline estimate of cash flows and (2) changes the estimated cost of an outstanding
direct loan (or direct loan obligation) or an outstanding loan guarantee (or loan guarantee commitment). There are two different types of modifications:

- **Direct Modifications** – Changes in the subsidy cost caused by altering the terms of existing contracts or by selling loan assets; and
- **Indirect Modifications** – Changes in the subsidy cost caused by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered.

**Negative Subsidy** – A subsidy cost that is less than zero. A negative subsidy will occur if the present value of cash inflows to the Government exceeds the present value of cash outflows.

**Nominal or Face Value** – The amount of a bond, note, mortgage or other security as stated in the instrument itself, exclusive of interest or dividend accumulations. Often referred to as the stated value or par value.

**Obligation** – A legally binding agreement that will result in outlays, immediately or in the future. An obligation is a legal liability of the Government against an available appropriation.

**OMB Credit Subsidy Calculator (CSC)** – Discounting tool issued by OMB for agencies to calculate credit subsidy costs and financing account interest for post-1991 loan guarantees.

**Positive Subsidy** – Positive subsidy value exists when the present value of expected cash outflows exceeds the present value of expected cash inflows.

**Present Value** – The current value of future cash flows.

**Program Account** – The Credit Program Account records the loan subsidy costs of the government that are associated with direct loans obligated and loan guarantees committed since 1992 and their related administrative expenses of the VA housing loan programs. The subsidy costs are calculated on a net present value basis. All administrative expenses are estimated on a cash basis.

**Re-estimate** – Estimates of the subsidy costs performed subsequent to their initial estimates made at the time of a loan’s disbursement. Per SFFAS 2, there are two different types of re-estimates:

- **Interest Rate Re-estimates** for differences between discount rate assumptions at the time of formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rate for the year of disbursement; and
- **Technical/Default Re-estimates** for changes in projected cash flows of outstanding loan guarantees after reevaluating the underlying assumptions and other factors that affect cash flow projections as of the financial statement date, except for any effect of the interest rate re-estimates.
Recognize – To formally record or incorporate an item into the Agency’s financial statements as an asset, liability, revenue, expense, etc.

Subsidy Cost – Estimated present value of the cash flows from the Government (excluding administrative expenses) less the estimated present value of the cash flows to the Government discounted to the time when the loan is disbursed. Present value is derived by a computation from the Credit Subsidy Calculator (CSC), mandated by OMB Circular A-11. Subsidy values can be either positive or negative.

Vendee Loan – Direct loan issued to a third-party borrower for the market value of the Real Estate Owned (REO) property. VA acquires REO property from a private sector mortgage lender upon default of a loan subject to the VA Loan Guarantee Program.

Vendee Mortgage Trust Securitization Program – VA’s program authorized under 38 U.S.C. § 3720(h) that “guarantees the timely payment of principal and interest on, certificates or other securities evidencing an interest in a pool of mortgage loans made in connection with the sale of properties acquired” under chapter 37, title 38 U.S.C. The VMT program helps to reduce VA’s cost associated with servicing loans. Upon the sale of loans to a third-party investor (Trust), VMT certificates are issued pursuant to a Pooling and Servicing Agreement (PSA) which is an agreement between VA, the Master Servicer, the Program Administrator, and the Trustee. VA guarantees the full and timely payment of principal and interest on VMT certificates. VA’s guaranty is backed by the full faith and credit of the United States Government.

0604 Roles and Responsibilities

Actuarial Services of the Office of Management (OM) is responsible for developing a statistical and predictive analytic model on proportions of foreclosures of the loan guarantee portfolio with review from the Office of Financial Management (OFM) Actuaries and Loan Guaranty Service (LGY). Actuarial Services prepares documentation on the statistical model, including information on variable selection, model summary regression output, calibration within the model, and output to use as inputs in the Credit Reform Staff (CRS) cash flow model.

Veterans Benefits Administration (VBA), Accounting Policy and Reporting Division (APRD), is responsible for reviewing the output received from VBA Credit Reform Budget and CSC models and posting journal vouchers to VA’s accounting system by fund and cohort level. APRD also reviews the historical cash flows and debt balances as well as the return of borrowing data to ensure accuracy and matching to Treasury reporting. As needed, APRD assists OFR in the reporting of loan liabilities.

VBA, Administrative and Loan Accounting Center (ALAC), is responsible for providing financial management support to VA’s housing programs by performing
accounting, financial reporting assistance, voucher examining, payments, and collections.

**VBA, Loan Guaranty Service (LGY)**, is responsible for operating and managing housing loan programs as a benefit for eligible borrowers to obtain, retain, and adapt homes.

**Credit Reform Staff (CRS), VBA** is responsible for calculating subsidy rates used by APRD and ALAC to compute subsidy expenses, and computes yearly re-estimates and subsidy-related adjustments to home loan receivables and the loan guarantee liability.

### 0605 Policies

#### 060501 General Policies

A. In accordance with SFFAS No. 2, VA will recognize and annually re-estimate loan guarantee liabilities.

B. VA will report loan guarantee liabilities and accompanying disclosures in accordance with OMB Circular A-136.

C. In accordance with OMB Circular A-11 and SFFAS No. 2, VA will utilize three categories of funds established by OMB to implement Credit Reform as follows:
   - Liquidating accounts for all pre-FY1992 loan activity;
   - Program accounts for OMB budgeted subsidies apportioned in the current year, plus all current year costs to administer the fund in which the loans are made; and
   - Financing accounts for all loan proprietary accounting, claims, and expense payments. Each account must distinguish all financial activity by fiscal year beginning with FY 1992 (cohort year).

D. VA will use Federal Credit Reform accounting for all guaranteed loans established October 1, 1991 and thereafter, including loans made or guaranteed prior to this date that had been substantially modified October 1, 1991 or later. The FCRA requires federal agencies to estimate the cost of extending or guaranteeing credit through federal credit programs, which is referred to as subsidy cost. VA will re-estimate subsidy costs annually to reflect both actual loan performance and changes in expected future loan performance.

E. Per OMB A-11, VA will use cohort accounting for post-1991 loan guarantees and pre-1991 loan guarantees that have been modified. Post–1991 loan guarantees remain with their original cohort throughout the life of the loans, even if they are modified. Modified pre–1992 direct and guaranteed loans are assigned to a single
cohort defined by the year of modification, program, and credit instrument, regardless of the fiscal year of the appropriation. For purposes of budget presentation, cohorts will be aggregated. However, accounting and other records must be maintained separately for each cohort.

060502  Loan Guarantee Liability

A. VA will recognize a liability for pre-1992 loan guarantees committed when it is more likely than not that the loan guarantee will require a future cash outflow to pay default claims.

B. VA will record the liability for post-1991 guaranteed loans outstanding at the present value of estimated net cash outflows of the guarantee upon commitment.

C. VA will adhere to the requirements of FCRA and use the net present value method for post-1991 guaranteed loans disbursed during a fiscal year to recognize subsidy expense.

D. In accordance with SFFAS 2, the liability for loan guarantees will be re-estimated each year as of the date of the financial statements.

E. Interest is accrued and compounded on the liability for loan guarantees at the interest rate that was used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed, after adjusting for the interest re-estimate. The accrued interest will be recognized as interest expense.

060503  Loan Sale Guarantee Liability

A. VA may bundle vendee and acquired loans and sell them to a third-party investor (Trust) pursuant to a sale agreement. VA guarantees that the investor will receive full and timely distributions of the principal and interest on the certificates backed by the full faith and credit of the Federal Government.

B. VA will adhere to the requirements of FCRA for post-1991 loan sale guarantees and record the guarantee for loans sold under the Vendee Mortgage Trust Securitization Program at the present value of their estimated net cash outflows to be paid by VA as a result of the guarantee.

C. When vendee loans are closed (i.e., legal ownership of the REO property has passed to the third-party borrower), VA will maintain the loan in a national loan portfolio until they are sold under the Vendee Mortgage Trust Securitization Program.

D. VA will publish planned loan sales in the President’s budget.
E. With OMB budget authority, VA will sell loans that meet the market criteria at the
time of sale provided they meet an economically viable threshold. The parameters of
the loan sale will fall within the range of either a minimum unpaid principal balance of
all outstanding vendee loans or a maximum percent of any cohort.

F. When a borrower fails to make a scheduled principal and interest payment on any
VMT loan, VA will make a guaranty payment to the VMT corresponding to the
borrower's missed payment.

G. VA will pay the remaining scheduled principal balance of a vendee loan in a VMT if
such loan is foreclosed and the ensuing property sale results in a liquidation loss.

060504 Subsidy Estimates and Re-Estimates

A. A subsidy estimate will be performed when a new VA guaranteed loan is made, or
an existing loan is modified. The FCRA requires the cost of loan guarantees be
estimated at present value for the budget providing the basis for evaluating program
performance by comparing actual accounting data with estimated budget data.

B. VA will recognize a subsidy expense for post-1991 guaranteed loans disbursed
equal to the difference between the present value of estimated cash outflows over
the life of the loans minus the present value of estimated cash inflows, discounted at
the interest rate of marketable Treasury securities with similar maturity to the cash
flows.

1. VA’s subsidy expense components for guaranteed loans disbursed during the
reporting year will be recognized separately among interest subsidy costs,
default costs, fees and other collections, and other subsidy costs.

2. VA’s total guaranteed loan subsidy expense is a combination of subsidy expense
for new guaranteed loans disbursed in the current year (1 above) plus
modifications to existing loan guarantees, adjustments and interest rate and
technical/default re-estimates made to existing loan guarantees.

C. When a positive subsidy rate exists, VA will receive loan subsidies in advance under
Federal Credit Reform, to finance expected losses on loans in the year that the
loans are made or guaranteed. VA will earn interest on these subsidies along with
other forms of collections to pay for future claims.

D. When a negative subsidy rate exists, VA will obligate an amount equal to the
negative subsidy in the financing account. When the loan is disbursed, the financing
account will pay the negative subsidy to the negative subsidy receipt account.
Collections will be recorded as offsetting receipts and offset VA’s budget authority
and outlays.
E. VA will re-estimate the subsidy costs each year as of the date of the financial statements to reflect the actual guaranteed loan performance and expected changes in estimates of future loan guarantees performance. The re-estimate will include both interest rate and technical/default considerations. All factors that may have affected estimated cash flows should be considered.

1. The Office of Financial Management within VBA will perform re-estimates in November and August.

   a. The re-estimate in November is for the purpose of preparing budget formulation. The VBA Credit Reform staff will prepare the re-estimate. The Office of Budget may review the re-estimates. VA will submit the re-estimate to OMB for approval.

   b. The re-estimate in August is for the purpose of preparing the financial statements. Preparing reliable and timely loan guarantee re-estimates for the financial statements must be a joint effort between the VBA Chief Financial Officer (CFO) and the loan guarantee program office of the Veterans Benefits Administration (VBA). The Office of Financial Management within VBA will review the re-estimate and the VBA Deputy Chief Financial Officer within this office will approve the re-estimate.

2. APRD will prepare the journal vouchers for the re-estimates and VBA Finance Center will enter them into VA’s accounting system. The re-estimate for financial statements will be recorded in September, while the re-estimate for budget formulation will be recorded after VA’s receipt of a reapportionment of the re-estimates from the Office of Budget.

F. VA will estimate and re-estimate default costs for each program on the basis of separate cohorts and risk categories. The re-estimate will consider the differences between projected and realized amounts as well as other changes in factors that can be used to predict future cash flows.

G. VA will consider the following risk factors in estimating default costs:
   • Loan performance experience;
   • Current and forecasted international, national, or regional economic conditions that may affect the performance of the loans;
   • Financial and other relevant characteristics of borrowers;
   • The value of collateral to loan balance;
   • Changes in recoverable value of collateral; and
   • Newly developed events that would affect the loans’ performance.

H. VA will maintain a database documenting historical performance using actual payments, pre-payments, late payments, defaults, recoveries, and amounts written off to further estimate default costs.
I. VA will re-estimate interest rate costs due to changes in interest rates from those assumed in the budget preparation cycle to those prevailing during the time periods in which the guaranteed loans are actually disbursed.

J. VA will exclude costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, from subsidy estimates. These costs are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of loan guarantees.

K. When making estimates for expected collections of the loan fee authorized by 38, U.S.C. § 3729, Loan Fee, VA will consider that there are Veterans who may qualify for a loan fee waiver and thus are exempt from paying the fee.

L. VA must maintain documentation that supports the underlying assumptions used in the subsidy calculations to facilitate VA’s review of the assumptions. Acceptable sources of documentation may be found in Federal Financial Accounting and Auditing Technical Release 3 (Revised): Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform—Amendments to TR 3, Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act. Appendix A: Acceptable Sources of Documentation for Subsidy Estimates and Re-estimates.

060505 Modeling Governance and Oversight

A. VA will use an econometric model to estimate specific assumptions regarding the Housing programs’ future performance and calculate future program cash flows. If individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted.

B. Board and Senior Management governance and oversight of modeling will include:
   • Review of modeling governance policies to ensure adequacy for models use and control;
   • Validation that procedures used for modeling comply with established policies;
   • Evaluation of security and change control procedures as well as risk assessment prior to contemplative changes to model; and
   • Establishment of formal Board/Committee tasked with overseeing modeling and modeling activities.

C. Detailed procedures for effective modeling oversight will be drafted to include:
   • Establishment of standards for controls and validation based on model criticality and complexity;
   • Verification of control procedures; and
• Formal definition for the roles of management, staff, internal audit, and other personnel relative to model development, use, controls, and validation responsibilities;

D. Modeling documentation should provide a thorough understanding of how the model works (model theory) allowing a new user to assume responsibility for the models use. Elements of documentation will include:
  • A description of the models purpose and design;
  • Model theory, including the logic behind the model and sensitivity to key drivers and assumptions;
  • Data needs;
  • Detailed operating procedures;
  • Security and change control procedures;
  • Validation plans and findings of validations performed; and
  • Controls over input data, algorithms, processes, and reporting frameworks.

060506 Modification of Loan Guarantees

A. OMB Circular No. A-11, Section 185, specifies that modifications to loan guarantees will result from any Government action that (1) differs from the actions assumed in the baseline estimate of cash flows and (2) affects the subsidy cost such as a change in the terms of the loan contract or legislation that provides new collection tools.

1. VA will calculate the cost of modification as the excess of the post-modification liability of the loan guarantee over the pre-modification liability. The modification cost will be recognized as modification expense when the loan guarantees are modified.

2. When a post-1991 guaranteed loan is modified, VA will adjust the loan’s liability book value to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loan’s maturity and discounted at the original discount rate.

3. When a pre-1992 guaranteed loan is modified VA will recognize that:
   a. A direct modification transfers the loan guarantee to the financing account and adjusts the book value equal to the post-modification liability. Any subsequent modification will be treated as a post-1991 loan guarantee.
   b. An indirect modification keeps the loan guarantee in the liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the indirect modification.
4. Changes in book value of pre-1992 and post-1991 loan guarantees from direct or indirect modification and the cost of a modification will normally differ due to the use of different discount rates or the use of different measurement methods. VA will recognize this difference as a gain or loss.

060507 Financial Reporting for Liabilities for Loan Guarantees

A. VA will report the liability for loan guarantees in its financial statements and accompanying note disclosures in accordance with OMB Circular A-136.

Key A-136 requirements to include:

1. VA will provide a description of program characteristics and disclose:
   - Amount of guaranteed loans disbursed in each program during the reporting year;
   - Estimated subsidy rates for the total subsidy and the subsidy components at the program level in the current year’s budget for the current year’s cohorts;
   - Events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have a significant and measurable effect on subsidy rates, subsidy expense, and subsidy re-estimates; and
   - Events and changes in conditions that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date.

2. VA will disclose in the notes to the financial statements the reconciliation between the beginning and ending balances of the liability for outstanding loan guarantees reported on the balance sheet. The reconciliation will display activities that affect:
   - Subsidy expenses for guaranteed loans disbursed during the period;
   - Subsidy re-estimates;
   - Fees received;
   - Interest supplements paid;
   - Loans written off;
   - Claim payments made to lenders;
   - Recoveries obtained; and
   - Other adjustments.

B. In accordance with SFFAS 2, Accounting for Direct Loans and Loan Guarantees, VA will use the present value measurement for financial accounting and reporting on all loan guarantees obligated or committed after September 30, 1991.
0606  Authorities and References

2 U.S.C. §661, Subchapter III, Credit Reform

38 U.S.C Part II, Chapter 20, Benefits for Homeless Veterans

38 U.S.C Part III, Chapter 3701, Housing and Small Business Loans


FASAB, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, Accounting for Direct loans and Loan Guarantees

FASAB, SFFAS No. 18, Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2

FASAB, SFFAS No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2

Federal Credit Reform Act of 1990


Office of Management and Budget (OMB) Circular No. A-11, Part V, Section 185, Federal Credit

OMB Circular No. A-129, Policies for Federal Credit Programs and Non-Tax Receivables


Treasury Financial Manual (TFM), Volume 1, Part 2, Chapter 4700, Appendix 1, 2 and 3

TFM, USSGL, Credit Reform Accounting Case Studies

0607  Rescissions

VA Financial Policy, Volume VI, Liabilities, Chapter 6 – Liabilities for Loan Guarantees dated October 2010.
0608 Questions

Questions concerning this financial policy should be directed to the following points of contact:

VBA   VAVBAWAS/CO/FINREP (Outlook)
VBA   VAVBAWAS/CO/OPERATIONS (Outlook)
All Others OFP Accounting Policy (Outlook)