



# Accounting for Loans is Risky Business

*Speakers: William Ellett and Amy MacHarg*

*Moderator: Brandi Morgan*

# Speakers



**MODERATOR**  
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**SPEAKER**  
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U.S. International Development  
Finance Corporation (DFC)



**SPEAKER**  
**Amy MacHarg**  
Director, Risk Management (OFPM)  
U.S. International Development  
Finance Corporation (DFC)

# Agenda

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- ✓ About DFC
- ✓ Federal Credit Reform
- ✓ Credit Risk
- ✓ DFC Loan Life Cycle – Risks and Controls Throughout
- ✓ Financial Reporting Risk
- ✓ Model Risk Management
- ✓ Questions

# Polling Question #1

What experience do you have in federal credit programs?

- A.) None
- B.) Limited
- C.) Some
- D.) Extensive

# About DFC

U.S. International Development Finance Corporation (DFC) is the **U.S. Government's development finance institution.**

DFC partners with the private sectors to finance solutions to the **most critical challenges** facing the developing world today.



# DFC: Where We Work



\*Please note: The above exposures exclude cross-cutting limits on insurance claims.

# About DFC



## Dual Mandate

- ✓ Development Impact
- ✓ US Foreign Policy



## Product Types

- ✓ Debt
- ✓ Insurance
- ✓ Direct Equity
- ✓ Investment Funds

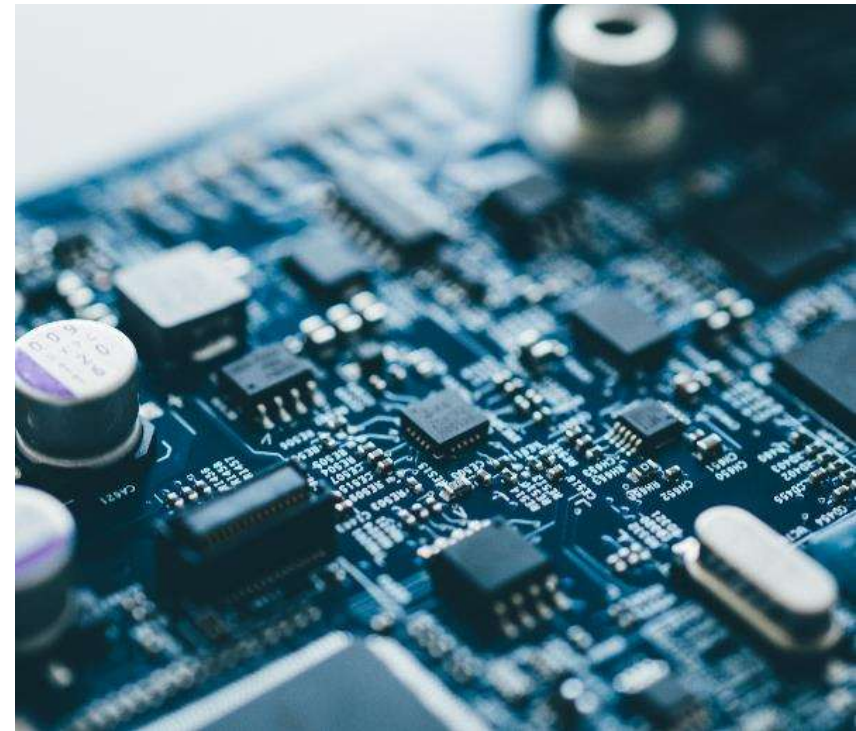


## Key Initiatives

- ✓ Infrastructure
- ✓ Health
- ✓ Energy
- ✓ Food Security
- ✓ Small Business

# Federal Credit Reform Act (FCRA)

- Under FCRA the cost of federal credit programs are measured on a net present value (PV) basis
- The accounting standards follow the budgetary treatment provided under FCRA





# Federal Credit Reform Act (FCRA)

- Direct loans disbursed and outstanding are recognized as assets net of a subsidy cost allowance equal to their estimated PV
- Subsidy expense equals the PV of the estimated cash outflows of the loan minus the PV of estimated cash inflows
- Costs are estimated by cohort, which are groupings based on the year of obligation and risk category



# Federal Credit Reform Act (FCRA)

- Loans are funded by a combination of the subsidy and borrowings
- Modifications are funded by current year appropriations
- Reestimates are funding by permanent, indefinite appropriations



## Polling Question #2

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Have you personally ever had a federal loan or federally guaranteed loan?

A.) Yes

B.) No

# Federal Credit Reform Act (FCRA)

- As of September 30, 2023, the US had
  - \$1.7 trillion in direct loans, net outstanding
  - \$2.1 trillion of loan principal under guarantee

Source – *Financial Report of the United States Government, Fiscal Year 2023*



# Federal Credit Reform Act (FCRA)

- As of September 30, 2023, DFC had
  - \$10.2 billion direct loans, net outstanding
  - \$9.6 billion of loan principal under guarantee
- No two DFC loans are alike
- Each loan has a subsidy cost or rate unique to that loan



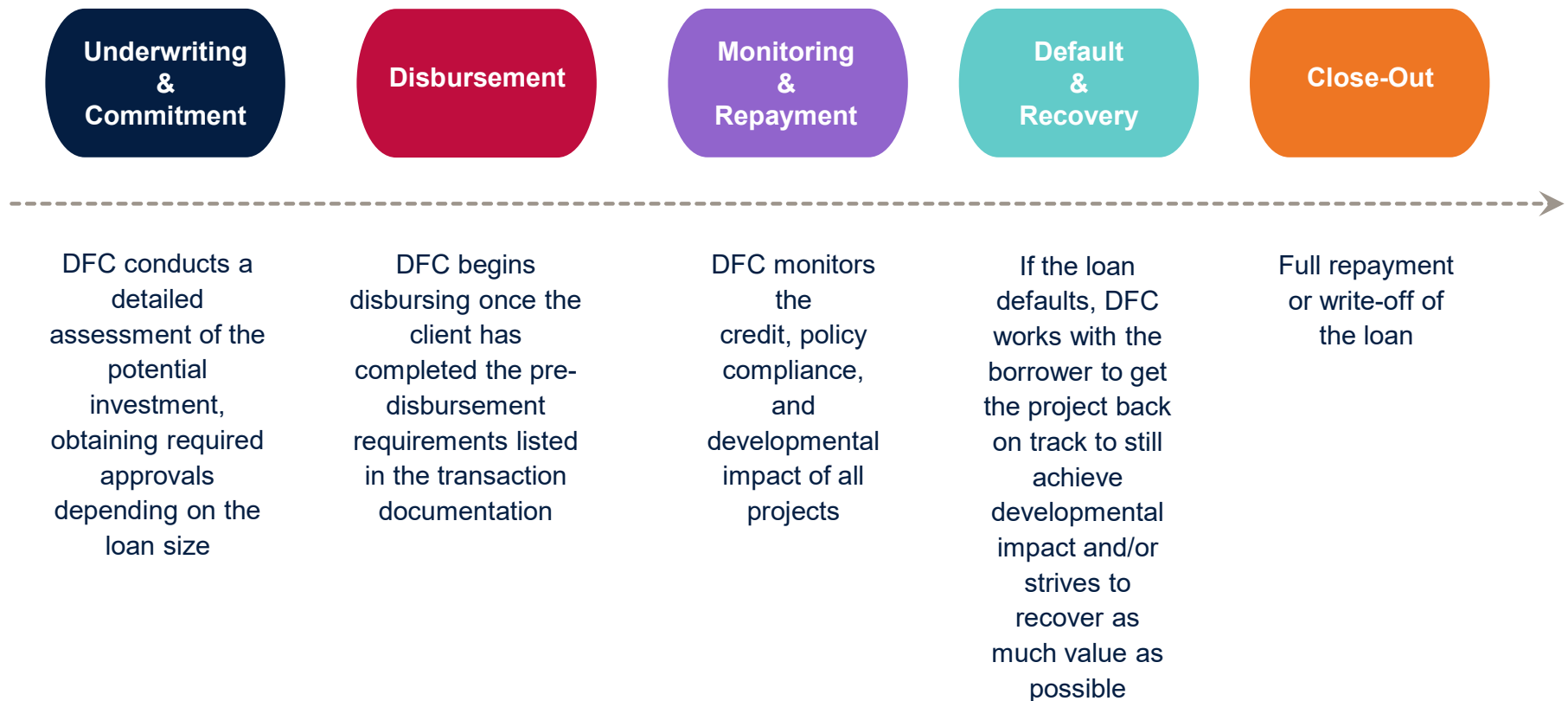
# Credit Risk

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- Risk of financial loss from failure to repay
- Key risk DFC monitors throughout the life cycle of a project
- Measurable:
  - ✓ Probability of Default (PD)
  - ✓ Loss Given Default (LGD)
  - ✓ Country Risk

# Loan Life Cycle



# Underwriting and Commitment

- Detailed assessment of the potential client:
  - ✓ Business plan
  - ✓ Financial model
  - ✓ Financial statements
  - ✓ Expected project impact
  - ✓ Legal compliance
  - ✓ Character risk
- Review process: DFC management, credit and investment committees, Board of Directors
- Commitment:
  - ✓ Countersigned Commitment Letter
  - ✓ Obligating event





# Underwriting & Commitment Risks



## Risks

Credit Risk

Reputational Risk

Impact Risk



## Controls

- ✓ Due Diligence Process
- ✓ Risk Ratings/Loss Given Default (LGD) estimates
- ✓ Subsidy Estimate
- ✓ Management and Board Review and Approvals
  
- ✓ Know Your Customer (KYC)
- ✓ Policy Clearances
  
- ✓ Impact Scoring

# Disbursement



- Many prerequisites must occur before a disbursement can be made on a committed loan
- Partial or full disbursement
- Track record of on-time disbursements with no error

# Disbursement Risks



## Risks

Credit Risk

Timing and  
Accuracy



## Controls

- ✓ Additional clearance for transactions with high credit risk
- ✓ Multiple levels of management and legal review and approval
- ✓ Validation of conditions precedent
- ✓ Prior validation of wiring information
- ✓ Disbursement checklists
- ✓ Systems automation

# Repayment & Monitoring



- DFC individually monitors every loan
- Monitoring focuses on 2 aspects - financial success and policy/impact
- DFC employs a risk-based approach to allocating monitoring resources

# Repayment & Monitoring Risks



## Risks

Credit Risk

Portfolio Risk

Impact Risk



## Controls

- ✓ Active Monitoring Throughout Life of Loan
- ✓ Covenant Tracking
- ✓ Update Risk Ratings/LGDs
- ✓ Subsidy Reestimate
  
- ✓ Portfolio Reporting
- ✓ Country Concentrations
- ✓ Stress Testing
  
- ✓ Monitor Impact Progress

# Defaults and Recoveries



- Restructuring occurs upon default or to prevent an imminent default
- Common causes of default
- Recovery estimation
- As a government entity, DFC can be more patient than private-sector investors and often tries to still achieve impact and repayment

# Final Close-Out

- Full repayment or write-off of the loan
- Final reestimate and accounting
- Release of collateral
- Note cancellation
- Records
- Final project close-out impact evaluation



# Financial Reporting Risks



## Risks

Transaction  
Accuracy

Loan Modifications

Financial  
Statement and  
Note Disclosures



## Controls

- ✓ Multiple levels of management and legal review and approval
- ✓ Systems automation
- ✓ Determination is made by the Budget Team
- ✓ Quarterly validation of financial statement crosswalks
- ✓ Reporting Checklist based on GAO's Financial Audit Manual



# Subsidy Reestimate Risks



## Risks

Material  
Accounting  
Estimate

Data Integrity

Model Risks



## Controls

- ✓ Preliminary and final reestimate undergo rigorous review
- ✓ Special focus and validation on largest upward and largest downward (most are expected to range from +/- \$2 million)
- ✓ Manual and automated validation of data inputs
- ✓ Certification of data inputs
- ✓ Mid-year Reestimate Run
- ✓ IV&V

# Model Risk Management

## Model Risk:

- The potential loss an institution may incur due to decisions that are principally based on the output of internal models
- Can be caused by errors in development, implementation, or use



# Polling Question #3

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Does your agency have a Model Risk Management framework?

A.) Yes

B.) No

C.) I don't know

# Model Risk Management



## Risks

Source Data

Manual Input

Key Person

Model Assumptions

Calculation Errors

Output Reporting



## Controls

- ✓ Model Inventory and Risk Assessment
- ✓ Rigorous Testing
- ✓ Governance Policies
- ✓ Robust Internal Controls
- ✓ Independent Review
- ✓ Model Validation

# QUESTIONS



# Contacts and Resources



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