
Statement of Federal Financial Accounting Standards 7: Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

Status

Issued	May 10, 1996
Effective Date	For fiscal years beginning after September 30, 1997.
Volume II References	Revenue (R40), Prior Period Adjustments (P40), Seized and Forfeited Property (S30)
Interpretations and Technical Releases	Interpretation No. 1, <i>Reporting on Indian Trust Funds in General Purpose Financial Reports of the Department of the Interior and in the Consolidated Financial Statements of the U.S. Government</i> Interpretation No. 5, <i>Recognition by Recipient Entities of Receivable Nonexchange Revenue</i>
Affects	<ul style="list-style-type: none">• Paragraph 36(b), affects SFFAS 5, paragraphs 35-42 (Contingencies) by providing an exception to the general principle for accruing losses that are “more likely than not” on contracts for goods made to order or services provided to order.• Paragraph 53, affects SFFAS 1, paragraph 41, by providing additional guidance regarding accruing accounts receivable.• Paragraphs 90-102, adds a “statement of financing” to the group of reports discussed in SFFAC 2; affects SFFAC 2 paragraphs 64, 74, 105; and adds Appendix 1-G.• Paragraphs 264-269, affect SFFAS 3, paragraph 76 by providing additional guidance regarding account receivable recognition.• Paragraph 74-75, affect Technical Bulletin 2003-1, paragraphs 12-14, by providing guidance on accounting for transfers.
Affected by	<ul style="list-style-type: none">• SFFAS 13 defers the effective date of paragraph 65.2 of SFFAS 7.• TB 2002-2 affects paragraphs 79(g) by explaining what disclosures are required when an entity issues financial statements before the budget with “actual” numbers for the same year is published.• SFFAS 20 rescinded paragraph 65.2 and amended paragraph 107 and 187.1.• SFFAS 21 rescinded paragraph 76.• SFFAS 22 affects paragraphs 80 and 97.• SFFAS 27 affects paragraphs 83 through 87.

Summary

This Statement contains two separate parts. The first, on revenue and other financing sources, is composed of the introduction, accounting standards, and appendices. The second part of this document amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a new concept to satisfy users' needs for information that reconciles budgetary and financial accounting. Statements of Federal Financial Accounting Concepts articulate the framework within which the Board considers and recommends accounting standards.

Classification, Recognition, and Measurement of Revenue and Other Financing Sources

Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. The term "revenue" does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, so this Statement includes accounting standards for them.

These accounting standards recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price likely to be received. Thus, with some differences that are explained in the standard, the accounting for earned revenue is comparable to the private sector's accrual accounting for earned revenue. Exchange revenue includes most user charges other than taxes.

Nonexchange revenues include income taxes, excise taxes, employment taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., reasonably estimable).¹

In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power to demand payment becomes a legally enforceable claim to cash or other assets. For this

¹As explained in para. 44 of SFFAS Number 1, Accounting for Selected Assets and Liabilities, "more likely than not" means more than a 50 percent chance. "Not probable" means the converse, i.e., 50 percent or less.

reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. This basis of accounting amends the standard for the recognition of accounts receivable for taxes and duties.

Budgetary resources are recognized from two perspectives: the proprietary accounting perspective and the budgetary perspective. From the proprietary perspective, appropriations are accounted for as a financing source when used. Appropriations are used when an entity acquires goods and services or provides benefits and grants that are authorized to be paid by an appropriation. The remaining amount of appropriations enacted into law, but not yet recognized as “appropriations used,” is treated as capital, i.e., “unexplained appropriations.” This treatment parallels the recognition of expended appropriations during budgetary execution.

To the extent that other standards require that costs not on the entity’s books be imputed to the entity, the standards for other financing sources require recognition of the corresponding imputed financing.

Financial statements have not previously presented budget execution information needed by users of those reports. The standards presented in this document require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. The standards also require a reconciliation of proprietary and budgetary information in a way that helps users relate the two.

Disclosures, Supplementary Information, and Other Information

The different types of revenue, and the complexity of accounting for revenue and other financing sources, increase the importance of certain disclosures and other information. Briefly, the standards provide for:

- Extensive disclosures and other information about taxes and duties;
- Certain disclosures about exchange transactions where the full cost of goods and services sold is not recovered;
- Limited disclosure concerning accountability for dedicated collections;
- Disclosures and supplementary information from trust funds and the entities that make the collections for these trust funds where trust funds may be over- or under-funded in terms of applicable law; and
- Disclosures about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

Concepts for Reconciling Budgetary and Financial Accounting

This statement amends Statement of Federal Financial Accounting Concepts 2, Entity and Display, by adding a category of financial information to further satisfy users' needs and the objectives of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how information on the use of budgetary resources relates to information on the cost of program operations . . ." (sub-objective 1C). The objective of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

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Executive Summary

Scope

1. This Statement presents standards to account for inflows of resources from revenue and other financing sources. It provides standards for classifying, recognizing, and measuring resource inflows. These financial (proprietary) accounting standards differ from those used for budgetary accounting only to the extent essential to meet the Objectives of Federal Financial Reporting.

Classification, Recognition, And Measurement

2. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for “exchange revenue” is “earned revenue.” Nonexchange revenues arise primarily from exercise of the Government’s power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations. The term “revenue” does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, so this Statement includes accounting standards for them.
3. These accounting standards recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price likely to be received. Thus, with some differences that are explained in the standard, the accounting for earned revenue is comparable to the private sector’s accrual accounting for earned revenue. Exchange revenue includes most user charges other than taxes. Such user charges include regulatory user charges, in which the exchange is not wholly voluntary but the revenue is generally, but not always, related to the cost of providing service to identifiable groups. One example is the revenue derived from the Securities and Exchange Commission’s registration fees. Exchange transactions also include those intragovernmental transactions where the price serves as a full or partial reimbursement for the costs incurred.

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4. Distinguishing exchange revenue from nonexchange revenue and other financing sources enables the entity to report the net cost of operations of its programs (and the cost of the entity to the taxpayer) and provides the accounting foundation to report unit cost of output measures for performance evaluations. Requiring that exchange revenue be matched with the cost of outputs of goods and services sold to the public enables the entity to report the cost to the taxpayer of not charging the full cost of those goods and services.
 5. Nonexchange revenues include income taxes, excise taxes, duties, fines, penalties, and other inflows of resources arising from the Government's power to demand payments, as well as voluntary donations. Nonexchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. It is recognized to the extent that the collection is probable (i.e., more likely than not) and the amount is measurable (i.e., reasonably estimable).¹
 6. In the case of taxes and duties, inherent and practical limitations on the assessment process serve to delay the time when the power to demand payment becomes a legally enforceable claim to cash or other assets. For this reason, the method of accounting for taxes and duties can best be characterized as a modified cash basis of accounting, rather than an accrual basis. This basis of accounting amends the standard for the recognition of accounts receivable for taxes and duties. Cash basis tax revenue will continue to be accounted for as well, because of the fiscal importance of the information. The accrual accounting required will provide more accurate and complete information about receivables and refunds legally receivable and payable and about the components of the Government's revenue stream. The Board may review the standard for the accrual of taxes and duties after several years. The Board has provided that in the interim the IRS and Customs may on their own initiative modify this standard so that it reflects a fuller application of the accrual concept.
 7. Budgetary resources are recognized from two perspectives: the proprietary accounting perspective and the budgetary perspective.

¹As explained in para. 44 of SFFAS Number 1, Accounting for Selected Assets and Liabilities, "more likely than not" means more than a 50 percent chance. "Not probable" means the converse, i.e., less than a 50 percent chance.

From the proprietary perspective, appropriations are accounted for as a financing source when used. Appropriations are used when an entity has acquired goods and services or has provided benefits and grants that are authorized to be paid by an appropriation. The remaining amount of appropriations enacted into law, but not yet recognized as “appropriations used,” is treated as capital, i.e., “unexpended appropriations.” This treatment parallels the recognition of expended appropriations during budgetary execution.

8. To the extent that other standards require that costs not on the entity’s books be imputed to the entity, the standards for other financing sources require recognition of the corresponding imputed financing.
9. Financial statements have not previously presented budget execution information needed by users of those reports. Furthermore, concerns have been expressed about whether the budget is being properly executed in all cases. The standards presented in this document require the presentation and, consequently, the audit of information about budgetary resources, the status of those resources, and outlays. The standards also require a reconciliation of proprietary and budgetary information in a way that helps users relate the two.

**Disclosures,
Supplementary
Information, And Other
Information**

10. The different types of revenue, and the complexity of accounting for revenue and other financing sources, increases the importance of certain disclosures and other information.
11. Extensive disclosures and other information about taxes and duties compensate to some extent for the limited accruals under the modified cash basis of accounting. Such disclosures and other information also provide a better basis for estimating future cash flows, overseeing the custodial responsibilities given to the tax collecting entities, and understanding how the tax burden is shared.
12. Certain disclosures are required about exchange transactions where the full cost of goods and services sold is not recovered.
13. Limited disclosure concerning accountability for dedicated collections is required of reporting entities responsible for administering such funds. Supplementary information is required from those entities and the entities that make the collections in cases where trust funds may be over- or under-funded in terms of applicable law.

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14. Disclosures are required about the use of borrowing authority and the status of budgetary resources that may affect future spending by the entity.

Concepts For
Reconciling Budgetary
And Financial
Accounting

15. This statement amends Statement of Federal Financial Accounting Concepts No. 2, Entity and Display, by adding a category of financial information to further satisfy users' needs and the objectives of financial reporting. More specifically, the amendment is designed to meet users' need to understand "how information on the use of budgetary resources relates to information on the cost of program operations ..." (sub-objective 1C). The objective of this new category of information is to provide an explanation of the differences between budgetary and financial (proprietary) accounting. This is accomplished by means of a reconciliation of budgetary obligations and nonbudgetary resources available to the reporting entity with its net cost of operations.

Part I: Accounting
For Revenue And
Other Financing
Sources

Introduction

Background

16. The essential differences among exchange revenues, nonexchange revenues, and other financing sources affect the way they are recognized and measured under the accrual method of accounting. Properly classifying these inflows according to their nature, therefore, provides the basis for applying different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting objectives,² as

²Statement of Federal Financial Accounting Concepts No. 1, Objectives of Federal Financial Reporting.

they have been described in Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

17. To help meet those objectives, classifications were developed to determine what specific kinds of revenue should be deducted from the cost of providing goods and services by the reporting entities. Only revenue classified as exchange revenue should be matched with costs. Nonexchange revenue and other financing sources are not matched with costs because they are not earned in the operations process. Because they are inflows that finance operations, nonexchange revenues and other financing sources should be classified in accordance with other rules and should be recognized only in determining the overall financial results of operations for the period. This differs from the focus used in the private sector, where the focus is on net income for business organizations, and on changes in net assets for not-for-profit organizations. It is also a different focus from that used previously in reporting on U.S. Government operations. Under the old federal accounting standards, the focus was on matching all of an entity's financing with incurred expenses to report "net results of operations" which generally was not useful in evaluating performance. The new focus is on costs—both gross and net—which are useful in evaluating performance on many levels.
18. The concept of matching costs and revenue has little relevance in government except where there is an exchange transaction. An exchange transaction occurs when one party sacrifices value and receives a valuable good or service in return. The operations of an entity engaged in exchange transactions produce the revenue earned as well as the associated cost incurred. Therefore, financial accounting should relate the revenue to the cost for these transactions. The net effect—the gross cost minus the revenue, or the net cost—generally determines the extent to which taxpayers bear the cost of the operations.³
19. Information about the net cost of exchange transactions serves other purposes as well. Net cost gives one indication of the extent to which

³The only major exception is for intragovernmental sales of goods and services. The extent to which taxpayers bear the costs of these goods and services depends on whether the goods and services are sold to entities that in turn sell goods and services to the public, or to entities that are financed by taxes. The net cost of operations may also be financed by other nonexchange revenue such as fines, forfeitures, and donations.

people are willing to make voluntary payments to acquire goods or services of the kinds that are sold. It thus can give an indication of the extent to which people judge the products to have value. Net cost also can be used in evaluating an entity's pricing policy.

20. Most importantly of all, both net cost and gross cost can be compared with outputs and outcomes in assessing the effectiveness and efficiency with which resources are used to achieve results. Such comparisons can be used by agency management, the President, and the Congress in making decisions about allocating resources. These standards, together with those in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards, provide information essential to effective implementation of the Government Management Reform Act, which requires agencies to report performance measures such as unit cost. These standards, when applied in the context of applicable entity and display concepts, will make federal financial reporting more meaningful to those concerned with performance measurement.
21. Nonexchange revenue transactions do not require a Government entity to give value directly in exchange for the inflow of resources. The Government does not “earn” the nonexchange revenue. The cost that nonexchange revenue finances falls on those who pay the taxes and make the other nonexchange payments to the Government. The different character of nonexchange revenues requires that they be distinguished from exchange revenues. They should, therefore, be shown in a way that does not obscure the entity's net cost of operations.
22. Although Board Members have differing views on whether social insurance programs result in exchange or nonexchange transactions, they agree that social insurance tax revenues should be shown in the same way as other tax revenues for the purposes of financial reporting.⁴ Social insurance taxes, like other taxes, are determined by the Government's power to compel payment. Individuals and businesses that pay social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business. Especially for the major, broad-based social insurance programs— Social Security, Medicare (hospital insurance),

⁴See discussion of social insurance programs in FASAB's Exposure Draft, Supplementary Stewardship Reporting.

and unemployment compensation—the individuals and businesses have virtually no option except to pay.

23. The main sources of financing for the Government as a whole are exchange and nonexchange revenues and borrowing from the public. For component reporting entities, however, the sources of financing are provided through the budget and are largely financing sources other than revenue. Appropriations and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. These other financing sources are not earned by an entity's operations. Therefore, as with nonexchange revenue, they should be accounted for in a way that does not obscure the entity's net cost.
24. Budgetary resources have a different character than both exchange revenue and nonexchange revenue. Budgetary inflows should be shown in a way that reflects two different perspectives: the proprietary effect and the budgetary effect. Proprietary accounting treats these resources much as capital and lines of credit are treated in private sector accounting, and provides information about their availability in the Balance Sheet or in notes. Appropriations are recognized as capital when enacted into law, while borrowing authority is disclosed in notes. Because Government entities are expected to expend capital from appropriations rather than maintain it, the accounting for the use of appropriations differs in this respect from the private sector's accounting for capital. The accounting for "appropriations used" has been simplified and parallels their budgetary effect.
25. The budget provides the principal basis for planning and controlling obligations and expenditures by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to the apportionment, allotment, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than accrual accounting, are the bases for budgeting and reporting on budget execution.
26. Those who prepare financial statements have recognized that accrual accounting and the budget are complementary. Accrual-basis accounting often provides better information than cash-basis accounting for evaluating performance. It can provide more

information for planning and control of operations. Accrual accounting provides an understanding of a reporting entity's net position and cost of operations. U.S. Government financial statements have not been used for planning and control as well as they might have been. In part, this is because accounting standards have not been fully attuned to the Government's needs and circumstances. Another important reason is the continuing primacy of the budget as a financial planning and control tool. General purpose financial reports have not presented budget execution information with the financial statements in a way that helped users relate these two important, but different, types of financial information. The standards presented in this document provide the basis for reports that can deal with this problem.

Accounting Standards

Scope

30. These standards determine how a Government reporting entity should account for inflows of resources from revenue and other financing sources in its general purpose financial reports. Revenue is an inflow of resources that the Government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for "exchange revenue" is "earned revenue." Nonexchange revenues arise primarily from exercise of the Government's power to demand payments from the public, such as taxes, duties, fines, and penalties. Nonexchange revenue also includes donations.
31. The term "revenue" does not encompass all financing sources of Government reporting entities, such as most of the appropriations they receive. These other sources of financing do, however, provide resource inflows to Government reporting entities, although not to the Government as a whole. Accordingly, standards for accounting for these inflows are also provided.
32. Appendix B, "Guidance for the Classification of Transactions," provides authoritative guidance on which transactions should be classified as exchange transactions and which should be classified as nonexchange transactions or other financing sources.

Exchange Revenue

33. Exchange revenue and gains are inflows of resources to a Government entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return. That is, exchange revenue arises when a Government entity provides something of value to the public or another Government entity at a price.

RECOGNITION AND MEASUREMENT OF EXCHANGE REVENUE

34. Revenue from exchange transactions should be recognized when goods or services are provided to the public or another Government entity at a price.
35. When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.
36. Revenue from specific types of exchange transactions should be recognized as follows:
- (a) When services are provided to the public or another Government entity (except for specific services produced to order under a contract), revenue should be recognized when the services are performed.
 - (b) When specific goods are made to order under a contract (either short- or long-term), or specific services are produced to order under a contract (either short- or long-term), revenue should be recognized in proportion to estimated total cost when goods and services are acquired to fulfill the contract. If a loss is probable (more likely than not), revenue should continue to be recognized in proportion to the estimated total cost and costs should continue to be recognized when goods and services are acquired to fulfill the contract. Thus, the loss should be recognized in proportion to total cost over the life of the contract.⁵

⁵This standard is an exception to the general principle of SFFAS No. 5, Accounting for Liabilities of the Federal Government, which, but for this exception, would require a loss on a contract to be recognized at the time when expected costs exceeded expected revenue. However, the expected loss must be disclosed: see the disclosure requirement in paragraph (d) below.

- (c) When goods are kept in inventory so that they are available to customers when ordered, revenue should be recognized when the goods are delivered to the customer.
 - (d) When services are rendered continuously over time or the right to use an asset extends continuously over time, such as the use of borrowed money or the rental of space in a building, the revenue should be recognized in proportion to the passage of time or the use of the asset. The interest received on money borrowed in an intragovernmental transaction is an exchange revenue when the source of the borrowed funds is predominantly exchange revenue and is a nonexchange revenue when the source of the borrowed funds is predominantly nonexchange revenue or other financing sources.
 - (e) When an asset other than inventory is sold, any gain (or loss) should be recognized when the asset is delivered to the purchaser.
37. When advance fees or payments are received, such as for large-scale, long-term projects, revenue should not be recognized until costs are incurred from providing the goods and services (regardless of whether the fee or payment is refundable). An increase in cash and an increase in liabilities, such as “unearned revenue,” should be recorded when the cash is received. “Unearned revenue” should also be recorded if an agency requests advances or progress payments prior to the receipt of cash and records the amount.⁶
38. The measurement basis for revenue from exchange transactions should be the actual price that is received or receivable under the established pricing arrangements.
39. When cash has not yet been received at the time revenue is recognized, a receivable should be recorded. An appropriate allowance for estimated bad debts should be established.
40. To the extent that realization of the full amount of revenue is not probable due to credit losses (caused by the failure of the debtor to

⁶SFFAS No. 1, para. 41, provides that such request should be recorded if a claim to cash is established based on legal provisions, such as a payment due date.

pay the established or negotiated price), an expense should be recognized and the allowance for bad debts increased if the bad debts can be reasonably estimated.⁷ The amount of the bad debt expense should be separately shown.

41. To the extent that realization of the full amount of revenue is not probable due to returns, allowances, price redeterminations, or other reasons apart from credit losses, the revenue that is recognized should be reduced by separate provisions if the amounts can be reasonably estimated. The amounts of such provisions should be reflected as revenue adjustments, rather than costs of operations, and should be separately shown.
42. The recognition and measurement of revenue and credit losses due to direct loans and loan guarantees is determined by SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. Appropriate allowances should be established as determined by those standards.
43. Exchange revenue should be recognized in determining the net cost of operations of the reporting entity during the period. The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the costs of outputs and the total net cost of operations of the reporting entity. The components of the net cost calculation should separately include the gross cost of providing goods or services that earned exchange revenue, less the exchange revenue earned, and the resulting difference. The components of net cost should also include separately the gross cost of providing goods, services, benefit payments, or grants that did not earn exchange revenue.
44. The net amount of gains (or losses) should be subtracted from (or added to) gross cost to determine net cost in the same manner as exchange revenue is subtracted. Exchange revenue that is immaterial or cannot be associated with particular outputs should be deducted separately in calculating the net cost of the program, suborganization, or reporting entity as a whole as appropriate. Nonexchange revenues

⁷SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 40-52, is the standard for estimating bad debts. The standard is further explained in SFFAS No. 1's Basis for Conclusions, paragraphs 116-133.

and other financing sources should not be deducted from the gross cost in determining the net cost of operations for the reporting entity.

45. Under exceptional circumstances, such as rents and royalties on the Outer Continental Shelf, an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects.

45.1 The collecting entity should not offset its gross costs by such exchange revenue in determining its net cost of operations. If such exchange revenue is retained by the entity, it should be recognized as a financing source in determining the entity's operating results. If, instead, such revenue is collected on behalf of other entities (including the U.S. Government as a whole), the entity that collects the revenue should account for that revenue as a custodial activity, i.e., an amount collected for others.

45.2 If the collecting entity transfers the exchange revenue to other entities, similar recognition by other entities is appropriate.

- a. If the other entities to which the revenue is transferred also recognize virtually no costs in connection with the Government earning the revenue, the amounts transferred to them should not offset their gross cost in determining their net cost of operations but rather should be recognized as a financing source in determining their operating results.
- b. If the other entities to which the revenue is transferred do recognize costs in connection with the Government earning the revenue, the amounts transferred to them should offset their gross cost in determining their net cost of operations.

45.3 Because the revenue is exchange revenue regardless of whether related costs are recognized, it should be recognized and measured under the exchange revenue standards.

DISCLOSURES AND OTHER ACCOMPANYING INFORMATION

46. Each reporting entity that provides goods or services to the public or another Government entity should disclose the following:

- (a) differences in pricing policy from the full cost or market pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, User Charges (July 8, 1993), or in subsequent amendments in circulars that set forth pricing guidance;
 - (b) exchange transactions with the public in which prices are set by law or executive order and are not based on full cost or on market price;⁸
 - (c) the nature of intragovernmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, with explanations of the amount and reason for disparities between the billing (if any) and the full cost; and
 - (d) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract, and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable).
47. When making the disclosures called for by (a) and (b) in paragraph 46, cautionary language should be added to the effect that higher prices based on full cost or market price might reduce the quantity of goods or services demanded and, therefore, the difference between revenue received and such higher prices does not necessarily provide an indication of revenue foregone. If a reasonable estimate is practicable to make, the entity should provide as other accompanying information the amount of revenue foregone and should explain whether, and to what extent, the quantity demanded was assumed to change as a result of a change in price.

Nonexchange Revenue

RECOGNITION AND MEASUREMENT OF NONEXCHANGE REVENUE

The General Standard

48. Nonexchange revenues are inflows of resources that the Government demands or receives by donation. Such revenue should be recognized

⁸The pricing guidance in OMB Circular No. A-25 does not apply to prices set by law or executive order.

when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. Nonexchange revenue should be **measured** by the collecting entities, but should be **recognized** by the entities legally entitled to the revenue (the recipient entities). Paragraphs 49 through 63 describe the application of this general standard.

Taxes and Duties

49. **Revenue measured by the collecting entities.** Taxes and duties also should be measured on the cash basis, and the cash basis amount(s) should be shown in conjunction with the accrual amounts recognized. The source and disposition of revenue from taxes, duties (which are a type of tax), and related fines, penalties and interest should be measured by the collecting entities in a manner that enables reporting of (1) cash collections, refunds, and the “accrual adjustment” necessary to determine the total revenue and (2) cash or cash equivalents transferred to each of the recipient entities and the revenue amounts to be recognized by each of them. The collecting entities function in a custodial capacity with respect to revenue transferred or transferable to the recipient entities. The collecting entities should not recognize such revenue, but should account for and report upon the above mentioned custodial activities. The entities that collect taxes and duties may change the general standard (para. 48) to accrue amounts now required to be presented as supplementary information (paragraphs 67.1 and 67.2) and make other changes that would result in a fuller and more complete application of accrual accounting.
50. **Cash collections** should be based on amounts actually received during the fiscal period, including withholdings, estimated payments, final payments, and collections of receivables. Cash collections include any amounts paid in advance of due dates unless they are deposits.
51. **Cash refunds** should be based on repayments of taxes and duties during the period. Refunds include refund offsets and drawbacks. Refund offsets are amounts withheld from refunds on behalf of other agencies and paid to such agencies. Drawbacks are refunds of duties paid on imported goods that are subsequently exported or destroyed.

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52. **The “accrual adjustment,”** which modifies the net of cash collections and refunds to determine the amount of revenue recognized, should be the net increase or decrease during the reporting period in net revenue-related assets and liabilities. The net revenue-related assets and liabilities include accounts receivable, the allowance for uncollectible accounts, and amounts payable for refunds. Recognition standards for these accounts of the collecting entities are described in paragraphs 53 to 57.
53. **Accounts receivable** should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment processes to the extent the amount is measurable. This definition of accounts receivable from nonexchange transactions requires the standard for recognition of accounts receivable to be amended so that such receivables are not recognized on the basis of payment due dates but rather on the basis of the completion of the assessment processes.⁹ Under such processes, assessments are enforceable claims for which specific amounts due have been determined and the person(s) or entities from whom the tax or duty is due have been identified. Assessments include both self-assessments made by persons filing tax returns or entry documents and assessments made by the collecting entities.
54. Assessments recognized as accounts receivable include tax returns filed by the taxpayer (or customs documents filed by the importer) without sufficient payments, taxpayer agreements to assessments at the conclusion of an audit or to a substitute for a return (or importer agreements to supplemental assessments), court actions determining an assessment, and taxpayer (or importer) agreements to pay through an installment agreement or through accepted offers in compromise. Receivables determined to be currently not collectable are included, but assessments where there is no future collection potential such as where the taxpayer (or importer) has been either insolvent or deceased for specified periods are not included. Accounts receivable,

⁹SFFAS No. 1, Accounting for Selected Assets and Liabilities, para. 41, states that “a receivable should be recognized . . . based on legal provisions, such as a payment due date (e.g., taxes not received by the date they are due) . . .” Under the revenue standard, past due taxes are not recognized on the date they are due, but rather on the date when tax returns are received without sufficient payment or legally enforceable claims against non-compliant taxpayers are established through enforcement processes.

therefore, include only unpaid assessments made through the end of the period plus related fines, penalties, and interest. Accounts receivable do not include amounts received or due with tax returns received after the close of the reporting period or amounts that are compliance assessments¹⁰ or pre-assessment work in process.

55. **Compliance assessments and pre-assessment work in process.** Compliance assessments and pre-assessment work in process may or may not be legally assessed depending on the resolution of subsequent events.
- A. **Compliance assessments** are proposed assessments by the collecting entity in definitive amounts, but the taxpayer (or importer) still has the right to disagree or object, such as in the case of assessments made at the conclusion of an audit (or at the conclusion of a review by an import specialist or when a violation of applicable law is discovered), or the issuance by IRS of a substitute for a return, or where assessment is in appeals or in the tax court. These compliance assessments may become accounts receivable if the taxpayer files an amended return (or Customs' protest/retention period lapses), or an appeal or court action finally determines the assessment, or the taxpayer (importer) agrees to pay currently or through an installment agreement, or an offer in compromise is accepted.
- B. **Pre-assessment work in process** is assessments not yet officially asserted by the collecting entity which are subject to a taxpayer's right to conference in response to initial information notices, e.g., revenue agent reports (or are unasserted assessments on merchandise released into commerce for which the importer did not submit an entry summary document or for projected revenues due as a result of Customs' compliance measurement programs). The amount or range of amounts that will ultimately be assessed or the duration of the notice period may be reasonably estimable, but there are no amounts for pre-assessment work in process presently included in the dollar based accounting systems. Estimates of the amount or range of amounts of pre-assessment work in process that may ultimately

¹⁰Customs refers to "compliance assessments" as protested assessment amounts.

be collectable are not presently sufficiently reliable to be recognized.

56. **Allowance for uncollectible amounts** should be recognized based on an analysis of both individual accounts receivable and groups of accounts receivable, as prescribed by other standards.¹¹ A provision to increase or decrease the allowance will result in an adjustment of nonexchange revenue, rather than a bad debt expense.
57. **Amounts payable for refunds** (including refund offsets and drawbacks) should be recognized when measurable and legally payable under established processes of the collecting entities. The amounts include those refunds, where returns (or claims for refund) have been filed by the taxpayer and the Government has determined the specific amounts refundable and has identified the payee. Refunds with respect to returns or claims filed as of the end of the reporting period that do not require specific approval before payment are included in accounts payable for refunds.
58. **Other claims for refunds.** Claims filed for which specific administrative actions are required before payments can be made and unasserted claims for refund by taxpayers or importers that may or may not become payable depending upon the resolution of subsequent events.
- A. Claims filed for refunds where required administrative actions are not yet complete as of the close of the reporting period are not recognized. The refunds, however, may be reasonably estimable.
- B. Unasserted claims for refund such as unfiled claims for refunds or drawbacks for which no claim has been filed, are not recognized.¹² These amounts may be reasonably estimable, but are not presently included in dollar-based accounting systems.

¹¹SFFAS No. 1, Accounting for Selected Assets and Liabilities, para. 44 to 51, provides the basis for determining this allowance.

¹²Future income taxes from corporations may be reduced by more than \$100 billion dollars as a result of net operating loss carryforwards and tax credit carryforwards. Information in returns filed by corporations and in their financial statements appears to provide the basis for a reasonable estimate of the amount of potential reduced future income tax revenue attributable to these provisions of tax law. Information about net operating loss carryforwards is not an unasserted claim, as defined here.

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59. **Deposits.** Amounts voluntarily paid to the reporting entities as deposits, such as those made to stop the accrual of interest or those made pending settlements and judgments, are separately recognized as deposit liabilities.
60. **Revenue recognized by the recipient entities** should equal the sum of (a) cash or cash equivalents transferred to them by collecting entities and (b) the net change in any related inter-entity balances between the collecting and receiving entities (i.e., the amount to be transferred to the recipient entities from the collecting entity or vice versa). Equivalents are normally special Treasury securities issued by the Treasury Department acting in conjunction with the collecting entities. Inter-entity balances of amounts to be transferred normally should be recognized when (1) a legally enforceable claim exists between a collecting entity and a recipient entity for the transfer or repayment of taxes or duties, and (2) payment of such claim is probable and measurable. Inter-entity balances typically represent estimated settlements of transfers made during the period and revenue received by the collecting entity at year end but not yet transferred. Revenue should be recognized as a financing source in calculating the results of operations and not as a deduction in determining net cost of operations. Principles for the application of this standard to major groups of recipient entities are described in paragraphs 60.1 through 60.4.

60.1 Trust funds legally entitled to excise taxes collected. Certain trust funds are legally entitled to receive only excise taxes that are actually collected by the collecting entity. However, transfers to such trust funds currently are based on assessed excise taxes, because data on the components of cash collections by type of tax are not currently obtained from taxpayers. This standard affirms that revenues may be recognized on the basis of assessed excise taxes in lieu of excise taxes actually collected.

60.2 Trust funds legally entitled to receive Social Security taxes accrued. By law, the trust funds are to receive Social Security taxes on the basis of the earnings of participants and the applicable tax rates. Social Security taxes accrued are presently determined by the assessment processes of the Internal Revenue Service (IRS). Non-compliance by taxpayers may result in such amounts being less than taxes based on actual earnings of participants. Amounts for individual participants are separately reported to the Social Security

Administration (SSA), but because of employer reporting deficiencies these amounts are currently even less than amounts determined by the IRS. SSA is legally entitled to retain the higher amounts actually transferred by the IRS. This standard affirms that revenue should be recognized on the basis of the best available information, i.e., on the basis of the higher of the amount determined by the IRS assessment process or the individual participant amounts based on reports to SSA of participants' earnings, subject to any later adjustments necessary to bring the amounts transferred to the trust funds up to the amount of taxes due based on the actual earnings history of the participants.

60.3 Collecting entities entitled to retain revenue. When legally retained by the collecting entity as a reimbursement of the cost of collection, revenue should be recognized as an exchange revenue and deducted in determining the collecting entity's net cost of operations.

60.4 General Fund. The General Fund recognizes all nonexchange revenue not recognized by trust funds and other recipient entities. Interest on delinquent taxes should be recognized as exchange revenue. The General Fund should recognize in succeeding periods revenue adjustments for any recognized revenue that is determined after the books are closed for the period to have been properly transferable (or improperly transferred) to other recipient entities.

Fines and Penalties

61. Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. They may be imposed by the entities collecting taxes and duties, or by other government entities. The time when a claim to resources arises will depend on the nature of the fine and the associated legal and administrative processes. Some examples of conditions that, depending on the circumstances, could establish a legally enforceable and measurable claim include (1) the date by which an individual may contest a court summons expires, (2) the offender pays the fine before a court date, or (3) the court imposes the fine. An allowance for uncollectible accounts should, as in the case of taxes and duties, be recognized as a revenue adjustment and determined in accordance with other standards.¹³ The allowance

¹³SFFAS No. 1, para. 44-51.

should reduce the gross amount of the receivable and revenue to its net realizable value, based on the criterion that losses should be recognized to the extent it is probable (more likely than not) that some or all of the receivables will not be totally collected.

Donations

62. Donations are contributions to the government, i.e., voluntary gifts of resources to a government entity by a nonfederal entity. Donations may be financial resources, such as cash or securities, or nonfinancial resources such as land or buildings. Revenue arising from donations should be recognized for those inflows of resources which meet recognition criteria for assets¹⁴ and should be measured at the estimated fair value of the contribution.

Other Nonexchange Revenue

63. The various types of nonexchange revenue are described in Appendix B: Guidance for the Classification of Transactions. Some of these are not specifically mentioned in this standard. They should be recognized and measured in accordance with the general rule (see para. 48) except where other Board standards apply.

DISCLOSURES, SUPPLEMENTARY INFORMATION, AND OTHER ACCOMPANYING INFORMATION

Disclosures

64. **Basis of Accounting.** Collecting entities should disclose the basis of accounting when the application of the general rule of paragraph 48 results in a modified cash basis of accounting. The disclosure should point out the specific potential accruals which are not made as a result of this practice and the practical and inherent limitations affecting the accrual of taxes and duties. The disclosure should refer to the related other required disclosures and to the supplementary information and should mention that other accompanying information also provides related information. If a collecting entity adopts accounting standards that embody a fuller application of accrual accounting concepts, as

¹⁴For the recognition criteria for donated property, plant and equipment, see SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 30, 62, and 71.

permitted in paragraph 49, then the disclosure should describe that change in accounting and point out how it differs from that prescribed by this standard.

65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

65.1 **Accounts receivable.** Factors affecting collectability and timing of categories of accounts receivable and the amounts involved.

65.2 [Rescinded by SFFAS 20.]

65.3 **Cumulative cash collections and refunds by tax year and type of tax.** Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes.

66. If trust fund revenues are not recorded in accordance with applicable law, both the collecting and recipient entities should disclose the reasons.

Supplementary Information

67. Entities that collect taxes and duties should provide the following supplementary information relating to their potential revenue and custodial responsibilities:

67.1 The estimated realizable value, as of the end of the reporting period, of compliance assessments and, if reasonably estimable, pre-assessment work in process. The amounts furnished should represent management's best estimate of additional revenues likely to be collected from compliance assessments and from pre-assessment work in process, appropriately qualified as to their reliability. A range of amounts may be provided for pre-assessment work in process if estimable. The change in the total(s) of compliance assessments and

of pre-assessment work in process during the reporting period also should be provided.

67.2 If reasonably estimable, other claims for refunds that are not yet accrued but are likely to be paid when administrative actions are completed. If estimated, unasserted claims for refunds should be provided separately from claims filed and may be expressed as a range of amounts. The amounts furnished should represent management's best estimates, appropriately qualified as to their reliability. The change in the total of these amounts during the reporting period also should be provided.

67.3 The amount of assessments that the entity still has statutory authority to collect at the end of the period, but that have been written off and thus excluded from accounts receivable.

67.4 If reasonably estimable, the amounts by which trust funds may be over- or under-funded in comparison with the requirements of law.

68. Recipient entities that are trust funds should provide the same information as required for collecting entities in para. 67.4.

Other Accompanying Information

69. The following guidance for other accompanying information is intended to provide flexibility to enable preparers to present the most relevant information with respect to these topics, considering the needs and interests of users and the availability of data.

69.1 **A perspective on the income tax burden.** The IRS should provide a perspective on the income tax burden. This could take the form of a summary of the latest available information on the income tax and on related income, deductions, exemptions, and credits for individuals by income level and for corporations by size of assets. The objective is to show the tax burden borne by different classes of individuals and corporations and how that burden is affected by the tax rates, deductions, credits, etc., provided by the tax laws.

69.2 **Available information on the size of the tax gap.** Collecting entities should provide any relevant estimates of the annual tax gap that become available as a result of federal government

surveys or studies. The tax gap is defined as taxes or duties due from non-compliant taxpayers or importers. Amounts reported should be specifically defined, e.g., whether the tax gap includes or excludes estimates of taxes due on illegally earned revenue. Appropriate explanations of the limited reliability of the estimates also should be provided. Cross references should be made to portions of the tax gap due from identified non-compliant taxpayers which are shown as supplementary information, i.e., compliance assessments and pre-assessment work in process (para. 67.1).

69.3 Tax expenditures related to entity programs.

Information on tax expenditures that a reporting entity considers relevant to the performance of its programs may be presented, but should be qualified and explained appropriately to help the reader assess the possible impact of specific tax expenditures on the success of the related programs.

69.4 Directed flows of resources related to entity programs.

Information on directed flows of resources related to an entity's programs may be presented, but if this information is presented the estimated amounts should be accompanied by a description of the basis for the estimates and appropriate cautionary language about their reliability. Information should also be appropriately qualified and explained to help the reader assess the possible impact on the success of the programs.

Other Financing Sources

70. Financing sources, other than exchange and nonexchange revenues, that provide inflows of resources that increase results of operations during the reporting period include appropriations used, transfers of assets from other Government entities, and financing imputed with respect to any cost subsidies.¹⁵ Financing outflows may result from transfers of the reporting entity's assets to other Government entities or from exchange revenues earned by the entity but required to be transferred to the General Fund or another Government entity. Unexpended appropriations are recognized separately in determining net position but are not financing sources until used.

¹⁵Other accounting standards will determine the criteria for the imputation of costs and how those costs shall be measured. This standard provides guidance for accounting for the corresponding financing source that is reported in such cases.

RECOGNITION AND MEASUREMENT OF OTHER FINANCING SOURCES

Appropriations

71. **Unexpended Appropriations.** Appropriations, until used, are not a financing source. They should be recognized in capital as “unexpended appropriations” (and among assets as “funds with Treasury”) when made available for apportionment, even if a Treasury Warrant has not yet been received, or the amount has not been fully apportioned. Unexpended appropriations should be reduced for appropriations used and adjusted for other changes in budgetary resources, such as rescissions and transfers. The net increase or decrease in unexpended appropriations for the period should be recognized as a change in net position of the entity.
72. **Appropriations Used.** When used, appropriations should be recognized as a financing source in determining net results of operations.¹⁶ Appropriations are used in operations when goods and services are received or benefits and grants are provided. Goods and services (including amounts capitalized) are considered received when a liability is established. Benefits are considered to be provided when the related liability is established. Grants are considered to be provided when grantees meet the requirements that allow them to use the grants.¹⁷

Financing Imputed for Cost Subsidies

73. Government entities often receive goods and services from other Government entities without reimbursing the providing entity for all the related costs. In addition, Government entities often incur costs, such as for pensions, that are paid in total or in part by other entities. These constitute subsidized costs to be recognized by the receiving entity to the extent required by other accounting standards. An imputed financing source should be recognized equal to the imputed

¹⁶As is explained in the Basis for Conclusions, in the private sector, the term “net results of operations” is synonymous with net income and net income is the “bottom line” measure of performance for profit-seeking businesses. For most Government reporting entities, on the other hand, this is not the “bottom line” for performance measurement. See para. 224 and following.

¹⁷FASAB plans to undertake a project on accounting for grants.

cost. This offsets any effect of imputed cost on net results of operations for the period.

Transfers of Assets

74. An intragovernmental transfer of cash or of another capitalized asset without reimbursement changes the resources available to both the receiving entity and the transferring entity. The receiving entity should recognize a transfer-in as an additional financing source in its result of operations for the period. Similarly, the transferring entity should recognize the transfer-out as a decrease in its result of operations. The value recorded should be the transferring entity's book value of the asset. If the receiving entity does not know the book value, the asset should be recorded at its estimated fair value as of the date of transfer.
75. To the extent that a Government entity's exchange revenue that is included in calculating net cost of operations is required to be transferred to the Treasury or another Government entity, the amount should be recognized as a transfer-out in determining the net result of operations.¹⁸

¹⁸These transfers are distinguished from custodial transfers in that transfers involve assets that have been earned or in use by the entity in carrying out its programs whereas custodial transfers involve funds that have been collected on behalf of another entity. Accounting for custodial transfers is described in the section covering nonexchange revenue.

PRIOR PERIOD ADJUSTMENTS

76. [Rescinded by SFFAS 21.]

BUDGETARY INFORMATION

77. The budget is the primary financial planning and control tool of the government. For this reason, and because of the importance of this information to users of federal financial information, the following material budgetary information should be presented by reporting entities whose financing comes wholly or partially from the budget:

- (a) total budgetary resources available to the reporting entity during the period;
- (b) the status of those resources (including “obligations incurred”);
- (c) outlays.

78. Recognition and measurement of budgetary resources should be based on budget concepts and definitions contained in OMB Circulars A-11 and A-34. In addition, the reporting entity should provide this information for each of its major budget accounts as supplementary information. Small budget accounts may be aggregated.

79. The following information about the status of budgetary resources should be disclosed.

- (a) the amount of budgetary resources obligated for undelivered orders at the end of the period;
- (b) available borrowing and contract authority at the end of the period;
- (c) repayment requirements, financing sources for repayment, and other terms of borrowing authority used;
- (d) material adjustments during the reporting period to budgetary resources available at the beginning of the year and an explanation thereof;

- (e) existence, purpose, and availability of permanent indefinite appropriations;
 - (f) information about legal arrangements affecting the use of unobligated balances of budget authority such as time limits, purpose, and obligation limitations;
 - (g) explanations of any material differences between the information required by paragraph 77 and the amounts described as “actual” in the Budget of the United States Government;
 - (h) the amount, and an explanation that includes identification of balance sheet components, when recognized unfunded liabilities do not equal the total financing sources yet to be provided; and
 - (i) the amount of any capital infusion received during the reporting period.
80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different, causing differences in the basis of accounting. To better understand these differences, a reconciliation should explain the relationship between budgetary resources obligated by the entity during the period and the net cost of operations. It should reference the reported “obligations incurred” and related adjustments as defined by OMB Circular A-34. It also should include other financing sources not included in “obligations incurred” such as imputed financing, transfers of assets, and donations of assets not included in budget receipts. [Text deleted by SFFAS No. 22] The total of these items comprises obligations and nonbudgetary resources.
81. This total should then be adjusted by:
- (a) Resources that do not fund net cost of operations (e.g., changes in undelivered orders, appropriations received to pay for prior period costs, capitalized assets),
 - (b) Costs included in net cost of operations that do not require resources (e.g., depreciation and amortization expenses of assets previously capitalized), and

- (c) Financing sources yet to be provided (those becoming available in future periods which will be used to finance costs recognized in determining net cost for the present reporting period).
82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between the obligations basis used in the budget and the accrual basis used in financial (proprietary) accounting.

ACCOUNTABILITY FOR DEDICATED COLLECTIONS

[For funds meeting the definition of earmarked funds promulgated in SFFAS 27, paragraphs 83 through 87 are replaced by SFFAS 27. See SFFAS 27, paragraph 37.]

83. A reporting entity may be responsible for funds financed with dedicated collections that are held for later use to accomplish the fund's purpose. Some of these are held in a fiduciary capacity. Special accountability is required for the sake of the taxpayers or other contributors who make payments to the fund with the expectation that the collections will be used for the purposes for which they were dedicated, and for the sake of those who expect to benefit from the fund's future expenditures. Such funds include all funds within the budget classified as trust funds, those funds within the budget that are classified as "special funds" but that are similar in nature to trust funds, and those funds within the Federal universe (inside or outside the budget) that are fiduciary in nature. Management should, therefore, identify those special funds that are similar in nature to trust funds and those funds inside and outside the budget that are fiduciary in nature. Identification of funds that are similar in nature to trust funds is a judgmental matter; management is best qualified to make this judgment.
84. Separate financial information about these dedicated collections should be provided if they are material either to the reporting entity or to the beneficiary or contributors. The separate information may be reported on the face of the entity's general purpose financial statements, or the information may be disclosed in the notes to the financial statements. When not material to the reporting entity, this information may be provided separately in special reports to the contributors and beneficiaries (or their representatives) rather than

separately in the reporting entity's general purpose financial statements or notes thereto.

85. The following information, at a minimum, should be reported for individual funds that account for dedicated collections.

(a) A description of each fund's purpose, how the administrative entity accounts for and reports the fund, and its authority to use those collections.

(b) The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.

(c) Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable to beneficiaries, other liabilities, and fund balance.

(d) Condensed information on net cost and changes to fund balance showing revenues by type (exchange/nonexchange), program expenses, other expenses, other financing sources, and other changes in fund balance.

(e) Any revenues, other financing sources, or costs attributable to the fund under accounting standards, but not legally allowable as credits or charges to the fund.

When the above information is provided separately in special reports, as described in paragraph 84, the financial information required in (c) and (d) above should be combined for all such funds and the information described as "amounts for immaterial funds not presented separately in this general purpose report."

86. The law may require the accounting for a fund to be done in a particular way. The disclosures called for by item (e) are required if the fund's recognition requirements, as determined by law, are contrary to applicable accounting standards with respect to certain revenue, other financing sources, or costs. For example, a trust fund may be required to recognize revenue based on cash collected by the Government during the reporting period rather than the accruals due the Government. In the case of some funds, payments from the fund are also subject to legal limitations. Although the accounting used

within the fund itself should be in accordance with the applicable legal requirements, the larger reporting entity of which the fund is a component, the administrative entity, or the next higher level of the Government (e.g., a department or the governmentwide entity), should recognize the revenues, other financing sources, or costs associated with but not legally allowable to the fund.¹⁹

87. Most dedicated collections are included in the financial statements of the entity carrying out the program and responsible for administration of the fund. However, this may not be the case where collections are outside the budget or are not otherwise included in the reporting entity under the concepts of Entity and Display. In either case, the information is required to be disclosed. If more than one reporting entity is responsible for carrying out the program financed with the dedicated collections, then the entity with the largest share of the activity should be responsible for reporting all revenues, other financing sources, assets, liabilities, and costs of the fund.

Part II: Concepts For Reconciling Budgetary And Financial Accounting

Introduction

88. The Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, Entity and Display, was issued to provide conceptual guidance as to what would be encompassed by a federal entity's financial report. It identifies the types of financial information to be communicated to users and suggests the types of information to be included in an entity's report to help meet the objectives of federal financial reporting. Among other things, SFFAC No. 2 supports reporting both budget information and operating performance (i.e., proprietary) information to meet the needs of users and the objectives of reporting.

¹⁹When information on funds is reported separately and the basis of accounting is not in accordance with applicable accounting standards, the report should state that it is prepared on the basis of legal requirements.

The budget information focuses on the obligation and outlay of financial resources to acquire or provide goods and services as defined by budget concepts. Operating performance information focuses on the cost of resources used as defined by accrual accounting standards.

89. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition is necessarily different because of the difference in focus. To better understand the differences and make better use of the complementary information provided, information needs to be provided to reconcile the use of budgetary resources to acquire or provide goods and services with the net cost of using those goods and services. An approach to doing this was explored in the exposure draft, Accounting for Revenue and Other Financing Sources, and received substantial support from respondents. Therefore, Entity and Display is being amended to include in its concepts the need to communicate information about the differences between the use of resources as reported in the budget and in the net cost of operations.

Amendments To SFFAC
No. 2, Entity And
Display

90. The following heading and two paragraphs (numbered 91 and 92 in this document) are added to the section of SFFAC No. 2 titled “Displaying Financial Information.”

Reconciliation Statement—
Budgetary And Financial
Accounting

91. Subobjective 1C of the budgetary integrity objective states that information is needed to help the reader to determine “how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.” This objective arises because accrual-based expense measures used in financial statements differ from the obligation-based measures used in the budgetary reports.
92. To satisfy this objective, information is needed about the differences between budgetary and financial (i.e., proprietary) accounting that arise as a result of the different measures. This could be accomplished through a **Statement of Financing** that reconciles the budgetary resources obligated for a federal entity’s programs and operations to the net cost of operating that entity. The data presented could be for the reporting entity as a whole, for the major suborganization units, for

major budget accounts, or for aggregations of budget accounts, rather than for each individual budget account of the entity.

93. The Statement of Financing is added to SFFAC No. 2's suggested list of items included in the section titled "Financial Reporting for an Organizational Entity." In addition, a footnote (referenced to the Statement of Financing) shall be added stating:

OMB will provide guidance regarding details of the display for the Statement of Financing, including whether it shall be presented as a basic financial statement or as a schedule in the notes to the basic financial statements.

94. The following heading and paragraphs (numbered 95 through 101 in this document) are added to the section of SFFAC No. 2 titled "Recommended Contents for the Recommended Displays."

Statement Of Financing

95. The purpose of the Statement of Financing is to explain how budgetary resources obligated during the period relate to the net cost of operations for that reporting entity. This information should be presented in a way that clarifies the relationship between the obligation basis of budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship through a reconciliation, the statement provides information necessary to understand how the budgetary (and some nonbudgetary) resources finance the cost of operations and affect the assets and liabilities of the reporting entity. The appropriate elements for the Statement of Financing would be as indicated in the following paragraphs. They provide logical groupings of reconciling items that help the reader move from obligations to net cost of operations.
96. **Obligations incurred** are amounts of new orders placed, contracts awarded, services received, and other similar transactions during the period that will require payments during the same or a future period. A deduction is needed for spending authority from offsetting collections and recoveries of prior period obligations.
97. **Nonbudgetary resources** represent the net amount of resources received by the entity that are not included in budgetary resources. These items could include donations of assets, transfers of assets from (to) other federal entities, and financing imputed for cost subsidies. [Text deleted by SFFAS No. 22].

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98. **Resources that do not fund net cost of operations** are primarily (a) the change in amount of goods, services, and benefits ordered but not yet received or provided, (b) amounts provided in the current reporting period that fund costs incurred in prior years, and (c) amounts incurred for goods or services that have been capitalized on the balance sheet.
99. **Costs that do not require resources** are most commonly the result of allocating assets to expenses over more than one reporting period (e.g., depreciation) and the write-down of assets (due to revaluations).
100. **Financing sources yet to be provided** are the financing amounts needed in a future period to cover cost incurred in the current period.
101. The bottom line of this reconciliation would be the **net cost of operations**.
102. The following example financial statement format will be added to the appendices of SFFAC No. 2:

 Entity and Display, Appendix
 1-G

EXAMPLE FINANCIAL STATEMENT FORMATS - STATEMENT OF FINANCING - For the year ended September 30, 19X4

Obligations and Nonbudgetary Resources

Obligations incurred	\$XXX
Spending authority for offsetting collections and other budgetary adjustment	(X)
Donations not in the budget	X
Financing imputed for cost subsidies	X
Transfers-in (out)	X
Other	X
Obligations, as adjusted, and Nonbudgetary Resources	XXX

Resources That Do Not Fund Net Cost of Operations

Change in amount of goods, services, and benefits ordered but not yet received or provided	(X)
Cost capitalized on the balance sheet	(X)
Financing sources that fund costs of prior periods	(X)
Other	(X)

Costs That Do Not Require Resources

Depreciation and amortization	X
Revaluation of assets and liabilities	X
Other	X

Financing Sources Yet to be Provided

X

Net Cost of Operations

[\\$XXX](#)

Appendix A: Basis For Conclusions

103. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important considerations that FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.
104. FASAB published the exposure draft Accounting for Revenue and Other Financing Sources in July 1995. The exposure draft included 18 specific questions for respondents and invited comments on other topics. The Board received 42 letters of comment from the following sources:

Source	Internal To The U.S. Govt.	External To The U.S. Govt.	Total
Users, Academics & Others ²⁰	2	7	9
Auditors	10	1	11
Preparers	22		22
Totals	34	8	42

105. FASAB also held a public hearing on the exposure draft on September 20, 1995. One individual (a professor of accounting), representatives of four federal organizations that prepare financial statements, and representatives of one federal audit organization presented comments and discussed the exposure draft with the Board. Most of those who commented orally or in writing supported most of the provisions of the exposure draft. Most responses did suggest widening the proposed disclosures for trust funds to include other funds with similar special accountability for dedicated collections. Also, most respondents suggested retaining the customary business practice of recognizing bad debt expense for credit losses from exchange transactions. The Board made these changes. (See paragraph 128 for details on the change regarding credit losses. See paragraphs 226 and following for details on the change regarding disclosures for trust funds and similar funds). Concurrently with the widening of disclosures about funds, the Board required disclosures and supplementary information about any

²⁰This category includes representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other users

over- and under-funding of the trust funds (see para. 66, 67.4 and 68). The Board also made other less material changes in the exposure draft as a result of considering the comments it received.

106. As a result of further information received from IRS following the exposure draft, the Board made terminology changes with respect to “pre-assessments,” now referred to as “compliance assessments,” and “proposed assessments, now called “pre-assessment work in process.” More importantly, the Board provided for the possibility that amounts for pre-assessment work in process might not be reasonably estimable (see para. 67.1). As a result of further information from Customs following the exposure draft, the Board added a supplementary information requirement for unasserted claims for refund (see para. 67.2). (These include potential drawbacks that may approximate 20% of Customs reported revenue.)
107. After some deliberation, the Board also concluded that it would permit a fuller application of accrual accounting for taxes and duties than is required by the general rule (see para. 49). This would apply in the interim period between the issuance date of the Statement and any reconsideration of the standard by the Board. Coincident with extending the effective date of the standard for one year beyond that proposed in the exposure draft, and because of the importance of accurate information, the Board decided to require that material revenue-related transactions should be accounted for under a double entry accounting system (rather than estimated) and changed the designation of this information from supplementary to disclosure information ([Text deleted by SFFAS No. 20] see par. 65.3).
108. Finally, the Board recognized that, under certain circumstances, reporting entities may appropriately report information about tax expenditures and directed flows of resources that are related to their programs. However, the standard only permits this information to be presented as other accompanying information if it is properly qualified and explained (see para. 69.3 and 69.4).

Exchange Revenue

Special Nature of Government Exchange Transactions

109. Revenue from exchange transactions plays a different role in Government than in private business. Most Government output is provided to the public directly as the result of political decisions

rather than in exchange for revenue. This is regardless of whether the output is the provision of services, transfer payments to individuals, or grants to state and local governments. Likewise, most of the Government's receipts are collected as a result of exercising its power to compel tax payments rather than earned by providing goods and services to the public at a price.

110. Where Government goods and services are provided in exchange for revenue, prices may be set to cover cost. Sometimes they may be set in the market as they would be set by a business (such as auctioning the right to drill for oil on Government land). However, law or policy sets many prices below the amount that might be obtained in an auction or other market transaction (such as fees for grazing rights). In some of these cases, prices may be set with little or no regard to the related cost (such as fees to visit national parks).
111. Exchange transactions also occur between entities within the Government, sometimes as stipulated by law and in other cases by mutual agreement. These exchange transactions, also, are often not conducted at fair market prices. Services are often provided to a program free, such as the litigation the Department of Justice does for the Internal Revenue Service. Another common example is a central computer used without charge by several programs within an agency. Where charges are imposed, the internal sales price or reimbursement is not necessarily based on the full cost of providing the goods or services or on competitive market equivalents.
112. Some exchange transactions within the Government are carried out by intragovernmental revolving funds. In many instances, these funds have been established with the goal of recovering their full cost by selling their output. This would allow them to be self-sustaining from their sales, including the maintenance of their capital, without the need for additional appropriations. Goods and services must be priced at full cost to achieve this goal, but full cost is not always charged. As a result, revolving funds have often failed to be self-sustaining and have required extra appropriations.²¹

²¹Even revolving funds that are self-financing do not recover full cost from their customers if they are not charged for all of their own costs, such as pension and retirement health benefits for their employees.

Recognition: General Considerations

113. **Matching revenue with cost.** It is often said that private sector accounting matches expense with revenue to measure the net income of the business. This provides a measure of effort compared with accomplishment that cannot be used for most government activities. Most government activity either provides collective goods and service (such as national defense and justice) or redistributes income and wealth (as in benefit payments and grants). Therefore, the Government's output—its goods, services, transfers, and grants—is usually not provided in exchange for voluntary payments. In such cases, directly measuring the value that the Government's activity adds to society's welfare is difficult.

114. The Objectives of Federal Financial Reporting focuses on cost in relationship to accomplishment as the main objective in reporting an entity's operating performance. This is because of the fundamental importance of cost information. It is important to program managers in operating their activities efficiently and effectively. It is equally important to Executive and Congressional decision makers in making resource allocations. Subobjectives 2A and 2B declare that:

Federal financial reporting should provide information that helps the reader to determine ...the costs of providing specific programs and activities and the components of, and changes in, these costs... [and] the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.²²

115. The Board's explanation of the operating performance objective defines more exactly what this means:

...expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results.²³

116. SFFAS 4, Managerial Cost Accounting Concepts and Standards, discusses the need for Government accounting to emphasize cost as a way to improve decision making and program management. It says that good cost information can be used for: (1) budgeting and cost

²²SFFAC No. 1, Objectives of Federal Financial Reporting, paragraphs 126 and 128.

²³Ibid., para. 124. For more extended discussion, see *ibid.*, chapter 8. As explained there, difficulties arise in practice for many reasons, e.g., the specific measures that are appropriate and feasible will vary from program to program, outcomes are influenced by external factors as well as actions of government, focusing attention on selected measures can have unintended—and sometimes undesired—consequences, etc.

control, (2) performance measurement, (3) determining reimbursements and setting fees, (4) program evaluations, and (5) economic choice decisions (such as whether to contract-out a project).²⁴

117. To meet these goals, cost must be matched with the provision of goods and services to the public or other Government entities. To determine the net cost of an exchange activity—i.e., the part of the cost that is not offset by revenue earned from the goods and services provided—the related revenue must be matched with the cost.
118. Matching revenue with cost in a uniform manner is essential in evaluating agency performance and setting price. Cost and revenue must pertain to the same output in order to estimate the extent to which the revenue covers the cost. Therefore, costs should be matched against the provision of goods and services with revenue matched against those costs and thus with revenue also matched against the same provision of goods and services. When this is done, the gross and net cost of an entity can be compared with the related outputs and outcomes to evaluate its operating performance, pricing policy, and economic decisions. Similarly, when this is done, the net cost to the taxpayer can be estimated for the entity's related outputs provided to the public.
119. The standards in this Statement therefore use the accrual basis for recognizing exchange revenue and provide for matching exchange revenue against related cost as closely as practicable. The standards specify how the matching is to be achieved for different types of transactions.
120. **Assigning revenue to the costs of earning it.** Determining the net cost of producing outputs, providing programs, or carrying out missions will often be more important than determining the net cost for the reporting entity as a whole. A reporting entity may have several missions carried out by different suborganizations, all of them having component programs and outputs. For each of these, both gross and net cost are important in evaluating performance and managing cost. Furthermore, either an entity as a whole or its suborganizations and

²⁴SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, para. 31-40.

programs may have material costs that are not incurred to earn revenue, as well as material costs that are incurred for that purpose. Therefore, the revenue-earning and nonrevenue-earning components need to be separately evaluated in order to assess the net cost of particular activities. Additionally, various components may earn revenue but cover costs to different degrees.

121. In all these cases, the net cost of the reporting entity as a whole does not show the extent to which earned revenue covers the cost of providing a particular output. This can only be calculated for the entity's components. Determining the net cost for components is therefore essential to achieve the goals of the standards in this Statement: to match exchange revenue with the gross cost of outputs and to offset exchange revenue against that related gross cost.
122. To be most useful, therefore, the gross costs and net cost of operations should be calculated by suborganization, program, or output. Suborganizations are generally equivalent to responsibility segments as defined by the standards on managerial cost accounting.²⁵ Each responsibility segment must be able to assign full costs to the measurable outputs of its programs.²⁶ As a result, users of general purpose federal financial reports will be able to relate the net costs of a program to program outputs and outcomes.
123. Preparers should decide the exact classification of suborganizations and programs based on the nature of the entity, the missions and outputs for its GPRA strategic and annual performance plans, the concepts in Entity and Display, Federal accounting standards, and OMB's bulletin prescribing the form and content of agency financial statements. Exchange revenue should be assigned to the costs of outputs unless it is not reasonably possible to do so. If that cannot be done, exchange revenue should be assigned to the costs of programs, or, if that also is not reasonably possible, to the costs of suborganizations. Assigning exchange revenue to the components of an entity in this way is more effective for performance evaluation,

²⁵See *ibid.*, para. 77-88. Also see SFFAC No. 2, Entity and Display, para. 75 and footnote 14.

²⁶SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, para. 89-104 and 116-143.

price setting, and other purposes than assigning it to the reporting entity as a whole.

124. The gross cost, the exchange revenue, and the difference or net cost should be determined for each such component. The net cost and gross cost for each component could be used for such purposes as comparison with the outputs and outcomes of that component in order to assess the efficiency and effectiveness with which resources were used to achieve results.²⁷
125. Good information on gross cost and net cost, determined and analyzed in this manner, is essential to the success of the Government Performance and Results Act of 1993 (GPRA)²⁸ in relating costs to accomplishments. GPRA requires agencies to set performance goals for program activity and establish performance indicators to measure outputs and outcomes of the program activity. Performance measurement under GPRA is to begin in FY 1999, and pilot projects started in FY 1994. Under the OMB plan to carry out GPRA, performance reports will show the results of what was actually accomplished (outputs and outcomes) with the resources used. The net cost of operations (as well as gross cost) should be a fundamental measure of these resources.
126. **Uncollectible amounts.** When realization of the full amount of recognized revenue is not probable, the standards require that a separate provision be made if the uncollectible amount can be reasonably estimated. The Board defines “probable” as “more likely than not.” This definition, and measurability, are the criteria for recognizing losses due to uncollectible amounts of accounts receivable under Federal accounting standards.²⁹
127. Government entities have an extraordinary responsibility to be accountable—to the President, the Congress, and the public. Because of this, it is appropriate to show separately (1) the full revenue due

²⁷As noted previously, the specific measures of program economy, efficiency, and effectiveness that are feasible and appropriate will vary among programs.

²⁸Public Law 103-62.

²⁹SFFAS No. 1, Accounting for Selected Assets and Liabilities, paragraphs 44-45 and 124-30.

under their established pricing arrangements, and (2) the amount of this revenue that they estimate will not be realized.

128. The Exposure Draft proposed that the entire provision for estimated uncollectible amounts be recognized as a revenue adjustment. It reasoned that, if some of the potential revenue is not likely to be received, this should be viewed as the failure to realize revenue or the absence of an inflow of resources. Some of the respondents also viewed the entire uncollectible amount as a shortfall in revenue, but a majority believed that credit losses were a cost of doing business. Businesses extend credit in order to finance their customers, and any losses in this line of activity are another kind of expense. Such treatment is required for direct loans and loan guarantees that follow the credit reform accounting standards of SFFAS No. 2. A particularly telling argument, made by some, was that credit losses should be a component of full cost when establishing prices for the sale of goods and services. This would be facilitated by recognizing credit losses as a bad debt expense rather than a revenue adjustment. For these reasons, the Board concluded that credit losses should be recognized as an expense.
129. Uncollectible amounts due to other reasons— such as returns, allowances, and price redeterminations—would, however, be recognized as revenue adjustments. This treatment is parallel with the treatment in this Statement of taxes and other nonexchange revenue, where refunds, adjustments, and abatements are deducted from gross revenue rather than recognized as an expense. Under current practice and private sector standards, these uncollectible amounts are commonly treated as revenue adjustments but are not always separately disclosed.
130. The bad debt expense and the revenue adjustment each needs to be separately shown in order for the entity to be accountable for the different reasons why revenue is not collectible.
131. The allowance for bad debts should be based on an analysis of both individual accounts and groups of accounts, as appropriate under the circumstances. This principle is explained in the standard for accounts receivable.³⁰ For intragovernmental transactions, allowances for bad

³⁰Ibid., para. 44-51 and 131-133.

debts may not always be needed, because full payment can often be assumed.

Recognition: Special Cases

132. The general principles underlying exchange revenue recognition are supplemented for special cases.
133. **Gains and losses.** Gains and losses are recognized rather than revenues and expenses in order to differentiate unusual or nonrecurring transactions for evaluating an entity's performance or setting its prices. Material gains and losses are expected to be infrequent. They would normally be of a type that management would want to be considered in appraisals of its operations.
134. **Direct loans and loan guarantees.** Standards for direct loans and loan guarantees were established in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. The basic principle is to recognize the subsidy cost of the direct loan or loan guarantee as an expense when the loan is made. Subsidy cost is inherently a net concept: the present value of estimated cash outflows less the present value of estimated cash inflows over the life of the loan. This requires that the present value of estimated fees be recognized as a deduction in calculating subsidy cost, and that the present value of estimated defaults be included in calculating the subsidy cost. The standards for direct loans and loan guarantees that follow credit reform accounting thus differ from the standards in the present Statement in three respects: revenue is deducted in calculating the subsidy cost, bad debts are included in calculating the subsidy cost, and both revenue and bad debts are measured as present values.
135. Determining the subsidy cost in this way is a method of matching revenue with cost, and it is also a method of matching the subsidy cost with the provision of the subsidy to the public. SFFAS No. 2 is therefore consistent with the objectives of this Statement for exchange revenue, and the standards in this Statement do not apply to the recognition and measurement of revenue and credit losses for direct loans and loan guarantees that follow credit reform accounting. This exception includes pre-1992 direct loans and loan guarantees that have been restated on a present value basis. The guidance for classifying transactions in Appendix B reflects the provisions of SFFAS No. 2.

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136. **Exchange revenue collected for others.** Many entities that collect exchange revenue keep that revenue for their own use. Revolving funds keep the revenue they earn. By their nature, they are expected to finance at least a material part of their cost by selling goods and services in a continuing cycle of business-type activity. Other collecting entities may also keep the revenue they earn. Sometimes, however, the exchange revenue is transferred to the General Fund or to other entities in whole or in part. For example, the Southeastern and Southwestern Power Administrations transfer the revenue they collect from the public to the General Fund of the Treasury; similarly the Western Area Power Administration, while retaining some of the revenue that it collects, transfers the rest to the General Fund and various special funds designated by law.
137. As a general rule, exchange revenue transferred to others must be offset against the collecting entity's gross cost to determine its net cost of operations. Exchange revenue reduces the net cost of operations incurred by the entity in producing outputs, regardless of whether the entity keeps the exchange revenue for its own use or transfers it to another operating entity or the General Fund. Likewise, exchange revenue reduces the net cost of the entity's operations to the taxpayer regardless of its disposition. Therefore, all exchange revenue related to the cost of operations must be deducted from gross cost to determine the net cost of operations for the entity.
138. Any exchange revenue that is transferred to others, however, does not affect the collecting entity's net position. Therefore, as required by the standards for other financing sources, such exchange revenue is recognized as a transfer-out in calculating the entity's operating results.
139. The only exception to the general rule occurs when the entity recognizes virtually no cost in earning the exchange revenue, as explained in the following section.
140. **Exchange revenue unrelated to recognized cost.** In exceptional cases, an entity may recognize virtually no costs in connection with earning exchange revenue that it collects. A major example for many years has been the Minerals Management Service (MMS) of the Department of the Interior. It manages energy and other mineral resources on the Outer Continental Shelf (OCS) and collects rents, royalties, and bonuses due the Government and Indian tribes from

minerals produced on the OCS and other Federal and Indian lands. The rents, royalties, and bonuses are exchange revenues, earned by sales in the market. If the value of natural resources were recognized as an asset by MMS, then depletion could be recognized as a cost according to the units of production method as minerals were extracted.³¹ The revenue from rents, royalties, and bonuses could then be matched against MMS's gross cost, including depletion and minor other costs, to determine its net cost of operations.

141. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards the value of natural resources is not recognized as an asset. As a result, this exchange revenue cannot be matched against the economic cost of operations and bears little relationship to the recognized cost of MMS. Therefore, it should not be subtracted from MMS's gross cost in determining its net cost of operations. If it were subtracted, the relationship between MMS's net cost of operations and its measures of performance would be distorted. The net cost of operations of the Department of the Interior would likewise be distorted.
142. MMS collects this revenue acting as an agent for the recipients designated by law: the Treasury, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. Therefore, MMS should account for the exchange revenue as a custodial activity, which is an amount collected for others, in the same way as the Internal Revenue Service accounts for the nonexchange revenue that it collects. Because the revenue collected by MMS is exchange revenue, it should be recognized and measured under the exchange revenue standards when the rents, royalties, and bonuses are due pursuant to the contractual agreements.
143. The rents, royalties, and bonuses transferred to Treasury for the General Fund or to other Government reporting entities should be recognized similarly by these recipient entities. The revenue is exchange revenue and should be recognized and measured under the exchange revenue standards. However, neither the Government as a

³¹Methods of calculating depletion based on the economic cost of extraction, such as represented here, should be distinguished from depletion methods allowed under the Internal Revenue Code.

whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, the revenue should not offset the cost of operations for the U.S. Government as a whole or for these entities. As in the case of MMS, offsetting cost by this revenue would distort the relationship between the net cost of operations and the measures of the performance of these entities. The exchange revenue should instead be a financing source in determining the operating results and change in net position.

144. The Board is addressing the accounting for natural resources in a separate project. If it concludes that the value of mineral rights should be recognized as an asset and depletion as a cost, it would be appropriate to recognize the exchange revenue from rents, royalties, and bonuses in determining the net cost of operations.
145. Although MMS is the most prominent case of an entity collecting exchange revenue for which it recognizes virtually no cost, there can be other instances. The Federal Communications Commission collects exchange revenue from the auction of the radio spectrum. Such revenue should be accounted for in the same way as the revenue collected by MMS.
146. One respondent to the Exposure Draft asked about the meaning of the term “virtually no costs.” If an entity sells scrap metal or fully depreciated equipment, the exchange revenue or gain is not related to any cost that is recognized at the time of sale. These assets are recorded on the balance sheet as having no value at the time of sale, so the gross proceeds from the sale are not offset by any remaining book value in calculating the entity’s gain. However, unlike the auctions of petroleum rights or the radio spectrum, costs were recognized in past periods for the purchase of the materials or the use of the equipment. Therefore, offsetting the entity’s cost by its gains from sale provides a more accurate measure of its net cost of operations over time for comparison with measures of its performance over time. The standard has been clarified to say that the term “virtually no costs” means that virtually no costs are recognized during past periods as well as during the current period.
147. It is also possible that an entity’s cost accounting may not assign any costs to byproducts of its major goods or services. However, cost is recognized for the activities that produced both the major products and the byproducts. All revenue earned in connection with these

activities needs to be offset against the cost of these activities in determining the entity's net cost for the purpose of making comparisons with its measures of performance.

148. **Specific goods (or services) made to order compared with goods made for inventory.** When an entity produces goods for sale, revenue can be matched with cost in either of two ways: (1) revenue and expense can be recognized as costs are incurred, or (2) the expenditures can be recorded in inventory, with the revenue and expense recognized subsequently when the goods are delivered to the customer.
149. For specific goods made to order under a contract (or specific services produced to order), the standard requires that revenue be recognized as goods and services are acquired to fulfill the contract. More precisely, the standard requires that revenue, as determined by the contract price, be recognized in proportion to the estimated total cost as goods and services are acquired to fulfill the contract. This means that the percentage-of-completion method must be used and the amounts of revenue must be calculated based on the costs of the goods and services acquired to date to fulfill the contract in relationship to the estimated total cost under the contract. If the time period and estimated total cost are uncertain, revenue recognition should be deferred until a firm basis can be established to assign cost. Goods and services made (or produced) to order include such projects as building construction and ship repair, where costs are incurred over a period of time to provide a particular good or service to a specific customer according to characteristics determined by contract. They do not include the sale of standard services, such as electricity, under a contract.
150. Recognizing revenue and cost in this way provides an up-to-date measure of the entity's operations in providing goods and services. The revenue and cost are generated by the entity's activities during the current reporting period, unlike alternative recognition standards. In particular, this is unlike the completed contract method, under which the revenue and cost recognized in a period may have been generated substantially during previous periods. Because the revenue and cost recognized in the reporting period are up-to-date, they can more readily be compared with each other and with current outputs in evaluating the entity's performance and pricing policy in that period.

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151. In some instances, however, there may be no material difference between the percentage-of-completion method and the completed contract method. This is especially likely for small or short-term contracts. In such instances, the completed contract method could be followed.
152. The standard also requires that when a loss on a contract is probable (more likely than not) and measurable (reasonably estimable), it should be recognized over the life of the contract in proportion to the estimated total cost instead of immediately. This will come about by continuing to recognize revenue in proportion to estimated total cost and by continuing to recognize costs as goods and services are acquired to fulfill the contract. This requirement is an exception to SFFAS No. 5, Accounting for Liabilities of the Federal Government, under which a loss on a contract is recognized at the time when expected costs exceed expected revenue. The Board believes this exception is appropriate, because it provides a more accurate measure of the entity's net cost of operations during each reporting period than if the entire estimated loss were recognized in the single period when it was concluded that the loss was probable and measurable. The entire estimated loss, however, would be disclosed.
153. The standard is different when an entity produces goods to be kept "on the shelf" until ordered. It requires that manufacturing costs be charged to inventory and that revenue not be recognized until the goods are delivered to the customer. Costs and revenue are recognized later than when goods and services are made to order, because there is less assurance of revenue at the time when the costs are incurred. The term "delivery to the customer" includes instances in which the sale has taken place and the goods have been segregated or set aside for delivery.
154. **Classification of interest on intragovernmental balances.** Large amounts of interest are paid and received on intragovernmental balances. Most trust funds and some special funds and revolving funds have invested in special Treasury securities on which they earn interest due from the Treasury. Treasury and the Federal Financing Bank have made loans to a number of funds, on which those funds incur interest expense and on which interest is due to the Treasury or the Bank. The recorded interest revenue should be classified as exchange or nonexchange depending on the predominant source of funds upon which the interest payment is based. Other

intragovernmental balances bear no interest. The Board is considering a project that might result in imputing interest where the balances bear no interest or the interest does not reflect the cost of borrowing by the Treasury.

155. The interest on these intragovernmental liabilities has the form of an exchange transaction, but often it does not also have the substance of an exchange. The standards in this Statement and the guidance in Appendix B, "Guidance on the Classification of Transactions," differentiate among inflows of resources according to whether or not they should be deducted from an entity's gross cost in determining its net cost of operations. This differentiation depends fundamentally on whether the inflow of resources is related to costs that the entity incurs and recognizes in order to produce outputs and the inflow of resources.
156. When applied to the receipt of interest by a Government account from the Treasury, this criterion implies that interest should be classified in the same way as the predominant source of revenue to the fund: as exchange revenue, if the predominant source is exchange revenue; and as nonexchange revenue, if the predominant source is nonexchange revenue. If the invested funds come from exchange revenue, the interest on these funds derives from exchange revenue and the costs incurred to earn that revenue; if the invested funds come from nonexchange revenue, the interest on these funds is based ultimately on the government's power to compel payment rather than on a market transaction. With certain exceptions, this means that interest received by trust funds and special funds should be classified as nonexchange revenue, whereas interest received by revolving funds and trust revolving funds should be classified as exchange revenue. This is explained below, together with the exceptions and certain analogous transactions.
157. Invested balances of trust funds (and special funds) predominantly derive from earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes). To a lesser extent they derive from other financing sources (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs any costs. Therefore, the interest on Treasury securities should not be deducted

from the gross costs of the trust fund (or special fund) in determining its net cost of operations. As a result, that interest should not be classified as an exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue.

158. The invested balances of revolving funds, on the other hand, predominantly derive from the funds' business-type operations. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since the holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on their securities is related to the funds' costs of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue previously earned from the sales of goods and services, for which the funds incurred costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net cost of operations. For this reason, interest earned by revolving funds should be classified as exchange revenue.
159. A few revolving funds are classified by law as trust funds. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services; and the source is predominantly revenue previously earned from the sales of services, for which they incurred costs of operations. Their interest should therefore be classified in the same way as for other revolving funds, which is exchange revenue.
160. The three previous paragraphs explain the rationale for the normal classification of interest received by trust funds, special funds, revolving funds, and trust revolving funds. However, in some cases, the source of balances for trust funds and special funds may not be predominantly nonexchange revenue, and the source of balances for revolving funds and trust revolving funds may not be predominantly exchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and Disability Fund

and the Military Retirement Fund, consists of exchange revenue and other financing sources. In such exceptional cases, interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.

161. Agencies may receive authority to borrow from Treasury (or the Federal Financing Bank), and they pay interest on their borrowings. The interest is a cost to the agency and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the agency borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the agency is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.

162. When debt securities are retired before maturity, there may be a difference between the reacquisition price and the net carrying value of the extinguished debt. This difference is a gain or loss that should be classified in the same category as the interest on the extinguished debt.

Measurement

163. Exchange transactions with the public ordinarily take place at prices set by the agency or the Congress, such as electricity rates, book prices, and interest on delinquent taxes. Sometimes the market sets the price, as with the rents and royalties from companies that bid to explore and produce oil and gas on the Outer Continental Shelf. In either case the actual prices represent the inflow of resources to the entity and, therefore, are the appropriate basis for measuring revenue.

164. Except for prices set by law, OMB Circular No. A-25 and other regulations generally provide that user charges for transactions with the public should be set at full cost or market price.³² However,

³²Circular No. A-25, User Charges, as revised July 8, 1993, establishes Federal policy regarding fees assessed for government services and for the sale or use of government goods or resources. It implements the provisions of Title V of the Independent Offices Appropriations Act of 1952 (31 U.S.C. 9701), which generally calls for "each service or thing of value provided by an agency . . . to a person . . . to be self-sustaining to the extent possible" and says that charges shall be based on a number of specified criteria including "the costs to the Government." The guidance of Circular A-25 also applies to the assessment of user charges under other statutes. However, Circular A-25 is intended to be applied only to the extent permitted by law or executive order; it does not apply to the legislative and judicial branches or to mixed-ownership government corporations; and its requirements are deemed to be met by other OMB circulars that provide guidance concerning a specific user charge area.

compliance with these regulations is partial, and potential revenue is not realized in many cases. To help report users understand how the entity's operations are financed, disclosures are needed about (1) differences in pricing policy from the guidance in OMB's circular on user charges and (2) transactions where prices are set by law or executive order and are not based on full cost or market pricing. Other accompanying information is needed about the revenue foregone in these transactions but only if a reasonable estimate is practicable. The other accompanying information should explain whether, and to what extent, the quantity demanded was assumed to change as a result of the change in price.

165. Circular A-25 defines "full cost" as "all direct and indirect costs to any part of the Federal Government of providing a good, resource, or service."³³ This generic definition and the accompanying examples in the circular are generally consistent with the definition of "full cost" in the managerial cost accounting standards³⁴ and the recognition and measurement of many particular expenses in other Federal accounting standards.³⁵ However, unlike those standards, Circular A-25 also includes as part of the definition of full cost an annual rate of return on land, structures, equipment, and other capital resources (unless they are rented);³⁶ and it includes depreciation not only on structures and equipment that are classified as general PP&E (property, plant, and equipment), which is required by Federal accounting standards, but also on structures and equipment classified as stewardship PP&E, which in a few cases may be used in connection with the production of goods or services for sale.³⁷ Aside from these differences, the cost accounting and other accounting standards should enable the Circular

³³Circular A-25, section 6(d)(1).

³⁴SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, para. 93-107.

³⁵For example, the standards for expenses related to credit are stated in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees; and numerous standards for expense are stated in SFFAS No. 5, Accounting for Liabilities of the Federal Government.

³⁶The Board currently has a project to consider whether the rate of return on capital should be recognized as a cost in financial accounting statements.

³⁷The extent of differences between Circular A-25 and Federal accounting standards can be found by comparing Circular A-25, section 6(d)(1)(b), with SFFAS No. 6, Accounting for Property, Plant, and Equipment.

A-25 definition of full cost to be measured more accurately than has been possible heretofore.³⁸

166. The appropriate basis for measuring revenue from intragovernmental exchange transactions is likewise the actual price (or reimbursement) that the seller receives from the buyer. Accounting systems should be able to provide the information needed to set the reimbursement at full cost, but often the full cost is not charged. In these cases, the amount of the reimbursement is an incomplete measure of the economic value of the transaction. When one entity receives goods or services from another without paying all related costs, the net operating cost of the receiving entity is understated if it does not recognize (by imputation) the additional cost paid by the providing entity.
167. Other Federal financial accounting standards require such inter-entity cost subsidies to be recognized by the receiving entity in certain cases.³⁹ This Statement, in the section on “Other Financing Sources,” provides standards to recognize other financing sources that are imputed to offset whatever subsidy costs those other standards require to be recognized and imputed. Accounting for the imputed cost of goods and services provided by one Government entity to another requires the exercise of judgment, based on the specific circumstances of each case. Therefore, whether costs are imputed or not, the providing entity should disclose an explanation of the amount and reason for material disparities between the billing (if any) and the full cost.

³⁸Circular A-25 says that “full cost shall be determined or estimated from the best available records of the agency, and new cost accounting systems need not be established solely for this purpose.” See section 6(d)(1)(e). The cost accounting and other standards should improve agency records and specify the nature of costs more precisely and comprehensively.

³⁹The general principles for recognizing imputed cost are stated in SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, para. 105-115. The accounting is similar to the accounting for employee pensions and retirement health benefits, where the entity administering the plan does not provide goods or services to the reporting entity but does pay some or all of the cost. See SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181.

Nonexchange Revenue

Inherent Limitations

168. **Inherent limitations on the ability to perform accrual accounting for nonexchange revenue.** Accrual accounting recognizes the financial effects of transactions and events when they occur, whether or not cash changes hands at that time. As it does with respect to exchange revenue, full accrual accounting for nonexchange revenue would enhance financial planning, control, and accountability. Full accrual accounting could provide important data with respect to future cash flows and tax policy and could improve the ability to evaluate the performance of the collecting entities and the exercise of their custodial responsibilities.
169. Unfortunately, the degree of accrual accounting that is practicable to perform for taxes and duties is limited by difficulties in ascertaining the amount of revenue arising from the underlying events and by the assessment processes used to manage the collecting functions. Taxpayers may not ascertain taxable income until after the underlying events. They may not file returns on their due dates, and due dates are generally set by the administrative processes after the occurrence of the underlying event. Also, the extent of non-compliance is a function of the laws establishing these entities and the expectations by the Congress and the Administration about how diligently the collecting entities should perform their collection functions. These inherent limitations on the ability to perform accrual accounting were considered by the Board.

Practical Limitations

170. **Practical limitations were also considered by the Board.** The Board's standards for accrual accounting require that accruals mirror the established assessment processes of the collecting entities. As such, they do not require, for example, the accrual of taxes or duties which are likely to be assessed under established processes, but only those that are actually assessed under the defined processes of the collecting entities. Having accounting mirror the established process by which collecting entities interact with taxpayers has value, though arguably accounting for revenue should not be so limited.
171. At the time the Board began deliberations on this standard, accounting systems necessary to determine even the limited revenue accruals that are now required for taxes did not exist. The changes in systems required by this standard are limited to those necessary to mirror the

established assessment processes. The Board understands that the Internal Revenue Service is attempting to improve its collection function and the related management information systems. Because such systems must also provide accounting information, the Board decided not to impose accounting standards at this time that might conflict with systems changes needed to improve the efficiency and effectiveness of the collection process or go beyond the minimum changes considered necessary to enable the collecting entities to properly discharge their responsibilities.

Modified Cash Basis for Taxes and Duties

172. As a result of both the inherent limitations and the practical limitations accepted by the Board, the accrual standard, as it applies to taxes and duties, might be best characterized as a “modified cash” basis of accounting. These limitations on full accrual accounting required the amendment of the accounting standard on recognition of receivables as provided in paragraph 41 of SFFAS No. 1, which said, in effect, that taxes should be recognized as receivables when they are due from taxpayers.
173. In the future, the general standard for accrual as it applies to taxes and duties could be tightened to produce a fuller application of the accrual concept. For fines, penalties and donations, no accountable event precedes the recognition point established by this standard. Therefore, the general standard for recognition as it applies to these sources of revenue results in full accrual accounting for them.

Cash Basis Information Needed

174. Cash basis information on taxes and duties continues to be very important because it is widely used for planning purposes at present and is a component of the budget. It is also available soon after the close of the reporting period and is needed to comply with laws that require cash-basis accounting in particular instances. Unfortunately, accurate cash-basis information to meet certain legal requirements and other information needs is not presently available. This standard accepts the importance of both types of information and requires entities that collect taxes and duties to provide both types of information.

Potential Changes

175. Requirements for disclosures, supplementary information, and other accompanying information compensate to some extent for the modified cash basis of accounting for taxes and duties being approved at this time. In the future, the Board plans to evaluate users’

satisfaction with reports prepared on the basis of the standard and to give consideration to improvements being made in IRS processes and related management information systems. Based on this evaluation and consideration, it may propose to extend the degree of application of accrual accounting in several years time. In the interim, the Board will permit changes in accounting made at the initiative of a collecting entity if the changes represent a fuller application of accrual accounting than that prescribed by the standard. For example, compliance assessments for taxes or unasserted claims for drawbacks may be recognized rather than shown as supplementary information if the amounts are both probable and reasonably estimable.

Entities Responsible for Measuring and Recognizing Revenue

176. Collecting entities, e.g., the Internal Revenue Service and the Customs Service, collect cash and administer the assessment processes that provide the basis for adjusting those collections to an accrual basis. They, therefore, have measurement and reporting responsibilities for these inflows of resources. They also, at the direction of the Treasury Department, account for the disposition of these inflows to recipient entities. The Treasury determines the amounts payable to the recipient entities and, in conjunction with the collecting entities, makes the actual cash payments, or issues special Treasury securities, as necessary, to fund the amounts transferred. Because the recipient entities are designated by law to receive the inflows and make ultimate disposition of the funds, they, rather than the collecting entities, must recognize the inflows as revenues in order to provide financial statements which are meaningful to users.

Possible Over- and Under-funding of Trust Funds

177. The standard provides that trust funds should recognize the amounts transferred (and the change during the period of the amounts to be transferred) from the collecting entity as revenue despite the fact that those transfers may not be made on the basis of applicable law. In the case of excise taxes, transferring more than the amounts actually collected may cause these trust funds to be over-funded. The Board is advised by its legal counsel that this is a violation of law by the IRS. Such violations cannot be remedied unless, and until, the IRS adopts methods to collect the needed data from taxpayers. In the case of Social Security, weaknesses in the data collection methods may cause these trust funds to be under-funded. The Board is advised by its legal counsel that so long as IRS and SSA act on the basis of the best available information there is no violation of law. In considering these two situations, the Board concluded that it should not set an accounting standard with which the recipient entities could not

comply and, therefore, accepted the present basis of making transfers to them as the basis of recognition of revenue by them. However, the Board believes that both the collecting entity and the recipient entity have the responsibility to disclose any violation of law and to provide, as supplementary information, if estimable, amounts by which the trust funds may be over- or under-funded.

Conceptual Criteria for
Accrual and Limitations on
Their Application

178. As mentioned earlier, this standard recognizes both inherent and certain practical limitations on the application of the accrual concept to taxes and duties. The conceptual criteria for full accrual accounting for taxes and duties are the underlying taxable events, a precondition for the government to assert a demand for payment, and a demand date itself. A demand date conceivably could be as early as a date contemporaneous with the underlying events.
179. **The underlying taxable events.** Conceptually, certain Government taxes and duties could be accrued based on particular events, and certain others on events that take place over a period. Excise taxes and customs duties are examples of taxes based on particular events (sales or importing goods). Individual and corporation income taxes are examples of taxes based on events that take place over a period (e.g., income earned over the course of a year). Indeed, some taxpayers who prepare accrual-basis financial statements for themselves normally accrue taxes due to the government based on the underlying events.
180. Data about underlying events is supplied to collecting entities through returns required to be filed by taxpayers. Unfortunately, non-compliance with return requirements is estimated to account for more than \$100 billion annually in uncollected taxes. Only a relatively small portion of this amount is ultimately collected through the enforcement processes of the collecting entities. Estimates of this tax gap made from time-to-time have provided some information to guide enforcement efforts with respect to particular groups of tax payers, but do not provide sufficient information to establish claims against individual non-compliant taxpayers or defined groups of non-compliant taxpayers. Therefore, the underlying-event criterion for recognition can only be applied to the extent that taxpayers file tax

returns⁴⁰ or the collecting entities determine through their enforcement processes that specific non-compliant taxpayers owe or might owe taxes.

181. **The demand date.** To obtain taxes and duties, the government must demand the payment. The criterion for revenue recognition under this concept could be that the demand date for taxes and duties is the same as the date the underlying taxable event occurs or over the period that the underlying taxable event occurs, e.g., as taxable income is earned by the taxpayer. However, demand dates presently defined by established assessment processes are the dates payments are required to be received by the collecting entities. They include dates for withholding and estimated tax payment as well as the final due dates for tax returns. These dates provide administrative convenience for taxpayers and generally lag the underlying events. Because of the emphasis on cash, those payments made in advance of due dates for payment are not deferred for accounting purposes. Past-due taxes as a result of taxpayer failure to comply with established payment dates are not accrued until the collecting entities receive late tax returns from such taxpayers, or until the collecting entities determine through their enforcement processes that the Government has a legally enforceable claim. Only then are accounting accruals triggered under this standard. Those dates lag the underlying events by more than necessary to determine an accrual. The aforementioned limitations on the application of the demand criterion, which are arguably practical ones, further constrain the conceptual basis for accrual.

Limitations on the Scope of Accounting

182. Although relevant to the cost of the Government from an economic perspective, to Government fiscal policies, and to performance evaluation of Government reporting entities, the Board concluded not to require information on “tax expenditures” or expenditures that federal laws require others to make, i.e., “directed flows of resources.” There were a variety of opinions among Board members on the need for this information and different reasons given for not requiring some form of disclosure, but all Board members agreed that relevant

⁴⁰Even if all taxpayers filed returns, the underlying event criterion for most taxpayers is their income for the calendar year, whereas the government’s fiscal year ends September 30. Presently required estimated tax payments do not eliminate the problem of measuring taxes based on an “artificial” nine months period ending September 30 for calendar year taxpayers whose income for the following three month “stub” period ending December 31 could be disproportionate.

amounts are not normally measured under present accounting concepts. However, information may be provided under certain circumstances, but outside the financial statements themselves.

Some Benefits of this Standard

183. Some of the benefits of the accrual requirements of this standard:

- Reporting the “accrual adjustment” as a separately identified adjustment of taxes and duties collected. This preserves needed cash-basis information.
- Improving the data for both accrual- and cash-basis information. The standard accomplishes this because all transactions for which accounting could be performed under the standard will need to be processed. Some of these have not been accounted for in past financial reports because of delays in processing transactions at the end of the year.
- Accrual of assessments. Accounts receivable would be accrued based on returns filed or enforcement actions taken through the end of the period where such returns or actions have not yet resulted in cash receipts. A statistical estimate of the effect of this standard, as of September 30, 1993, disclosed approximately \$29 billion of net accounts receivable after deducting an allowance for uncollectible amounts of \$42 billion. Heretofore, net accounts receivable were thought to be in excess of \$100 billion. The accounting requirements for accrual should further improve the accuracy of the amount of accounts receivable.
- Recognition of refunds payable will provide some indication of the lag in making refunds to taxpayers.

Some Things this Standard Does Not Accomplish

184. Some of the things this standard does not accomplish:

- Recognizing events after the close of the reporting period, such as cash received on later due dates, even if the receipt results from the underlying taxable events of the period. For example, unemployment taxes for the September 30 quarter are due in October and will be recognized in October if received on the October due date.
- Deferring recognition of revenue for tax payments that may be received before the demand or underlying event. For example, voluntary over-withholding by taxpayers will be treated as revenue.

- Recognizing compliance assessments and pre-assessment work in process or refunds before completion of the assessment processes. As a result, variations in the speed and effectiveness of the assessment processes will affect the amount accrued at the end of a fiscal period. Another result is that accounting information relative to measurement of the performance of the compliance functions by the collecting entities will not be available.
- Recognizing the tax gap, i.e., taxes (which include duties) due from unidentified non-compliant taxpayers and importers. As a result, this large potential source of revenue will not receive as much attention as it would if it could be made a formal part of the collecting entity's accountability.
- Accounting for "tax expenditures," which may contribute to the programs of reporting entities, or "directed flows of resources," which may substitute for program costs which might otherwise need to be incurred by reporting entities. These amounts are very large in relation to the "on budget" program amounts which are measured by accounting. As a result, these materially important performance and cost related data may not be fully considered.

Accounting Systems Changes

185. The IRS accounting system at present does not account for revenue transactions on an accrual basis and, therefore, does not establish accounts receivable, refunds payable, and the allowance for uncollectible accounts on the basis of the flow of all the various events and transactions affecting these balances. Instead of being an accrual accounting system, all assessments are recorded in an operating file not designed to do accounting and not operated under a double entry concept where the revenue effects of assessments are determined. That operating file, for example, includes multiple assessments made for the same tax claim so that the IRS can pursue all potential sources for the payment of that claim. As a result of the present limitations of this operating file, to determine the accounts receivable at any point in time, the IRS must make a statistical projection of a representative sample of valid tax claims. The potential error in the estimates made to date have been material, i.e., in excess of \$5 billion.
186. This standard contemplates that systems and accounting records will be put in place to permit the accurate determination and disclosure of all revenue and cash transactions which are reflected in the formal assessment process. By treating information relating to compliance assessments, pre-assessment work in process, and refunds before the

Disclosures, Supplementary
Information, and Other
Accompanying Information

completion of the assessment process as supplementary information, this standard contemplates that statistical estimates, rather than transaction-driven accounting systems and auditable subsidiary accounting records for individual taxpayers, may be used to provide the dollar values for these important revenue-related items.

187. This additional information will help users of federal financial reports in understanding the following:

187.1 Components of the revenue stream. By disclosing the dollar amounts of the material types of transactions reflected in the required “modified cash basis” revenue stream (from initial recognition by the established assessment process through cash collections and refunds), important accountability information for oversight and performance evaluation will be provided about the tax collection function. Providing as much accurate and detailed information as possible about the annual flow of taxpayer funds (now over \$1 trillion) is important because the administration of the collection function is to some degree discretionary.⁴¹

187.2 Cash flows. By disclosing cash flows by type of tax and tax year, accurate historical information will be provided about the source and timing of the annual flow. Material trends in collection and refund patterns may be apparent from the comparative financial statements presented and by reference to financial statements of prior periods. Both the ability to accurately forecast future flows and to understand the speed and effectiveness of the collection function should be enhanced by this information. Also, an indication of the degree of potentially correctable “error” from the use of a modified cash basis of accounting should be provided by this cumulative cash flow data.

187.3 Other future-oriented information. Disclosures about categories of accounts receivable provide additional information about collection problems and timing of future cash flows. At IRS,

⁴¹Pursuant to law, Customs establishes legal assessments for fines in amounts which frequently materially exceed the value of the goods, then subsequently abates the fine to a fraction of that value, also in accordance with applicable law. Full disclosure and explanation of practice should aid better understanding of the significance of assessments, abatements, and uncollectible amounts reported by Customs. [Text deleted by SFFAS No. 22.]

different categories of receivables vary considerably in terms of ultimate collectability and timing of collection.

187.4 Other potentially reportable revenue. Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment processes provides indications of the amounts of potentially accruable revenue. If such amounts were ultimately accrued, the “accrual adjustment” on a modified cash basis would be converted to an “accrual adjustment” that came closer to an estimate of the effect of full accrual accounting. Some or all of these potential accounts receivable and payable may become measurable by the collecting entities, and the Board may require their accrual when the collecting entities’ management systems are improved.

187.5 Sharing of the income tax burden. Other accompanying information about the tax gap and IRS historical information showing income, deductions, and credits by income level (assets for corporations) responds to those concerned with the extent of non-compliance with the laws and how the income tax burden is shared among compliant taxpayers.

187.6 Administration of the tax laws by the collecting agencies. Disclosures, supplementary information, and other accompanying information provide a more complete picture of how the collecting agencies are functioning. This information may be relevant to allocation of resources to collecting agencies, to their performance appraisal, and to their oversight.

- Supplementary information on compliance assessments and pre-assessment work in process and on refunds before the completion of the assessment process shows the backlog in processing assessments and refunds.
- The disclosure and supplementary information with respect to over-and under-funding of the trust funds identifies administrative problems to be overcome.
- Disclosure of abatement of assessed taxes with respect to non-compliant taxpayers (\$37 billion by the IRS in 1993) provides some information about the administrative discretion exercised by collecting entities. However, no information is required about reductions of possibly material amounts in compliance assessments and pre-assessment work in process as a result of

the resolution of examinations, investigations, protests, and litigation. Therefore, accounting reports will not include data about these processes, which involve an even higher degree of administrative discretion than the formal assessment process. Nor will they provide data, e.g., compliance assessments made during the reporting period, that might be related to the cost of compliance, e.g., salaries of revenue agents and related administrative costs, that might be relevant to evaluating the performance of the collecting entities' compliance function.

Tax Gap

188. The exposure draft proposed that available information about the nonexchange revenue gap, including the tax gap, be provided as “other accompanying information.” This information would not have been subject to audit, and the auditor’s responsibility would have been limited to reporting if it was materially misleading in light of the information gathered during the audit. Substantially all of the revenue gap is the tax gap because duties are technically a type of tax, so the Board decided to deal only with the tax gap. The sources of non-compliance that cause the tax gap include unreported income, overstated exemptions, and overstated deductions. The largest component of the tax gap relates to income taxes. IRS originally estimated the gross income tax gap at \$94 billion for tax year 1987. The net income tax gap for 1987, which is the gross income tax gap less the estimated amount that has been or will be collected through IRS’s enforcement efforts, is now estimated at \$72 billion. Thus, with respect to 1987, later collections from non-compliant taxpayers are about \$22 billion. Estimates of the income tax gap cover only taxes on legally earned income of individuals and corporations—not taxes owed from illegal sources of income such as drugs and prostitution.⁴²
189. Estimates of the tax gap by IRS have been made from time to time. Congress recently concluded not to authorize a current study⁴³ and there is no present plan to conduct another one. On the other hand, Customs makes estimates of amounts due from unknown non-compliant importers. The Board concluded, therefore, that the

⁴²For details see Net Tax Gap and Remittance Gap Estimates (Supplement to Publication 7285), Publication 1415 (4-90), Internal Revenue Service; and Tax Gap: Many Actions Taken, But a Cohesive Compliance Strategy Needed, GAO/GGD-94-123, May 1994.

⁴³The Tax Compliance Measurement Program (TCMP) planned for 1996.

standard should require only that any estimates by the Government of the tax gap be presented when they were relevant, i.e., provided reasonably current information is available.

190. Some respondents to the exposure draft believed that tax gap information is important, but others believed it is too imprecise to be a required disclosure. The Board considered establishing a new category of information “Required Supplementary Stewardship Information” (RSSI) for the “unidentified persons or entities” portion of the tax gap. This concept is also being considered for application to certain “Stewardship Information.” The Board concluded that for the time being this standard should say that available information about the tax gap should be provided as other accompanying information. In addition to the tax gap information requirements (see para. 69.2), other accompanying information is required or permitted under certain circumstances with respect to (a) the income tax burden (see para. 69.1), (b) tax expenditures (see para. 69.3), (c) directed flows of resources (see para. 69.4), and (d) revenue foregone for exchange transactions (see para. 47).

191. The Board intends to review the requirements in this standard to provide other accompanying information when it considers standards for the Management Discussion and Analysis (MD&A). The Board may decide to modify the information requirements when it considers the degree to which this information should be subject to some sort of audit scrutiny. Auditing standards for the MD&A have not been established by any auditing standard setters, including the Comptroller General, who establishes standards for auditors who audit federal organizations, programs, and activities. It is expected that audit standards for an MD&A will be considered by the Comptroller General’s Advisory Council and standards may be set later by the Comptroller General. Particular audit requirements for MD&A may be set by agreement between OMB and GAO if consistent with any such standards then existing. When the Board’s project on MD&A is considered, OMB and GAO plan to give consideration to the auditing requirements for MD&A and to the concept of RSSI.

Tax Expenditures

192. Tax expenditures are estimates of the revenue foregone because of preferential provisions of the tax structure. They are due to special exclusions, exemptions, deductions, credits, deferrals, and tax rates that depart from a “baseline.” These exceptions are generally intended to achieve public policy objectives by providing benefits to qualifying

individuals or entities or by encouraging particular activities. They also may be intended to improve tax equity or offset imperfections in other parts of the tax structure. Tax expenditures are not revenue. They are not inflows of resources to the reporting entity.

193. The following are some examples of tax expenditures (with estimates from the Treasury Department of the revenue foregone in FY 1995):

- the exclusion from gross income of the housing and meals provided military personnel (\$2.0 billion);
- tax credits for expenditures to preserve and restore historic structures (\$0.1 billion) and to produce “alternative” fuels (\$1.0 billion);
- exclusion from gross income of employee compensation in the form of health insurance premiums and other medical care (\$59.4 billion); and
- deductions for mortgage interest (\$48.1 billion) and state and local property taxes (\$15.3 billion) on owner-occupied homes.

194. The Board considered a proposal to require each reporting entity to provide supplementary information on tax expenditures related to its missions. The amounts reported would have been the Treasury Department’s estimates that are published in the President’s budget.

195. Those who supported that proposal believe that this information is relevant to evaluating the performance of Government programs that have related tax expenditures. Some of these tax expenditures are very closely tied to program operations. Others are less closely tied to an agency’s operating activities but still relate to its mission. For example, the preferential treatment of owner-occupied homes can be related to HUD’s mission to promote good housing for the nation.

196. Furthermore, policy makers may compare changes in tax expenditures with changes in direct budgetary outlays. They did so, for example, in 1983 and 1993 when they increased the taxation of Social Security benefits but alternatively could have reduced the cost-of-living adjustment. In ways such as these, the reporting on the costs and accomplishments of an entity is incomplete unless it includes the tax expenditures related to its missions.

197. The Board decided not to require supplementary information on tax expenditures in component entity financial statements for several

reasons. The definition of the baseline for comparison is in part a matter of values and judgment. In some cases the association with particular programs is not sufficiently clear. Furthermore, the information is available elsewhere now. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on tax expenditures that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

- Directed Flows of Resources
198. The Board considered a proposal to require each entity to provide supplementary estimates of the material annual expense to nonfederal entities of existing federal laws and regulations associated with its programs. The requirement would have been limited to regulations that establish standards for the characteristics of products or for the methods of production, or that mandate expenditures by state and local governments. These estimates would not necessarily have included nonpecuniary costs, although nonpecuniary costs might have been included to the extent identifiable. Each entity also would have provided any appropriate explanations about availability of data and limitations on the reliability of the estimates.
 199. Advocates of the proposal believe that the Government pursues some of its goals by requiring states, local governments, and private entities to spend funds for specified public purposes. For example, the Government may require states to extend the coverage of Medicaid, communities to have water treatment plants that meet Government safety standards, firms to minimize their workers' exposure to asbestos, and automobile manufacturers to install air bags. When the regulations apply to state and local governments, they are generally called "unfunded mandates."
 200. The costs and financing of federal regulations do not flow through the Government, but their effects are similar to the effects of direct federal expenditures and revenue. Fundamentally, both regulation and federal expenditure allocate resources to the purposes specified by the Government. The cost of regulation includes regulations imposed in the past as well as newly issued regulations. Furthermore, expenditure required by regulation may be an alternative means of achieving the same public policy goals as direct federal expenditure or other methods. For example, Medicaid coverage may be extended with or without more federal grants.

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201. Advocates of this requirement believe that financial reports that omit important financial effects of Governmental action do not fairly present the results of the Government's operations. Such reports fail to achieve the objectives of federal financial reporting. They believe that the efforts and accomplishments with which an agency pursues its goals can be properly assessed only if the financial reports include all material information. This means that the reports should bring together information about the net cost of operations, the tax expenditures, and the directed flows of resources that are intended to achieve the same or similar missions.
202. The Board decided not to require supplementary information on directed flows for several reasons. Much of this information is not available now and will not be available to preparers of financial reports without added expense. In some cases the estimates would be very imprecise. Finally, most Board members believe that the scope of Government financial reporting should not extend to flows of financial resources that are not inflows to, or outflows from, federal Government reporting entities. However, the Board agreed to permit reporting entities to present, as other accompanying information, information on directed flows of resources that the reporting entity considers relevant to its programs, if suitable explanations and qualifications are provided.

Other Financing Sources And Budgetary Resources

General Principles

203. The standards for other financing sources and budgetary resources should satisfy several of the objectives of financial reporting such as: (1) explaining the relationship of budgetary resources obligated to the net cost of operations, (2) showing how budgetary resources were used and the status of budgetary resources at the end of the period, and (3) indicating the effect on the net results of operations of the entity of all the financing sources used to finance the net cost of operations. However, financing from a financial accounting (proprietary) perspective is different than the budgetary accounting perspective.

204. The budget is the primary financial planning and control tool of the Government. Its objectives, such as planning resource allocation, authorizing and controlling obligations, planning cash disbursements, and raising revenue, differ from those of financial reporting where the focus is on net cost of the entity's programs and activities and stewardship of its assets and liabilities. Differing objectives are responsible for some but not all of the many differences in these two financial management tools. Differences in standards for measuring and reporting budgetary and financial information, coupled with unreliable data, have caused financial statements to be underutilized by Government managers, the budget community, and others who might benefit from financial information.

Reducing Differences

205. The problem of unreliable data is being addressed through financial statement audits that will include both proprietary and budgetary information and improvements in financial management systems. These federal accounting standards reduce unnecessary differences between the information reported in these two tools of financial management and require reconciliations and data to explain necessary differences. This should increase the utility of the financial planning and control information provided by the flow statements in general purpose financial reports and enhance the usefulness of the other accountability information provided, e.g., the Balance Sheet. This should occur because those who focus on the budget will better understand the financial statements and find them to be reliable and useful reports.

206. The new recognition and measurement standards for financial accounting adopt budgetary flow concepts for appropriations and provide consistent flow standards for nonbudgetary resources. As explained earlier, standards for recognition of nonexchange revenue reported by Government entities reflect legal requirements. These changes make the reporting on financing for entity net costs more consistent among entities and more comparable to the budget.

207. However, differences inherent in the different objectives of the budget and the financial statements must remain. The obligation basis for the budget differs from the costs-incurred basis for the financial statements. This difference must continue in order for both types of information to serve their purposes. Some budgetary resources are used to invest in assets and therefore are not reflected in operating costs. Also, an entity may incur costs that were covered by previously

provided budgetary resources (e.g., depreciation), costs not yet covered by budgetary resources (e.g., accrued annual leave), or costs covered by budgetary resources of other entities (e.g., some pension costs). Continuing these differences in the accounting reports is essential if financial statements are to report cost information that can be related to entities' outputs and if the statements are to report other information on the resources over which the entities are accountable. These remaining differences need to be explained in the financial statements to increase the utility of the financial statements.

The Budgetary Process and Its Linkage to Accounting

208. The budget controls obligations and thus ultimately controls expenditures by Government entities. In this sense, it is about their outflows of resources. Conversely, the budget makes inflows of resources available to component entities to finance expenditures. The inflows are reported in the financial statements as revenues and other financing sources (e.g., appropriations).
209. The budgetary process provides a component entity with budgetary resources through appropriations acts. Budget authority may be provided in the form of appropriations, borrowing authority, contract authority, or spending authority from offsetting collections. An appropriation may make funds available from the General Fund, special funds, or trust funds—including amounts received from earmarked taxes—or may authorize the spending of offsetting collections credited to expenditure accounts. Budgetary resources also include unobligated balances remaining from prior reporting periods and a number of adjustments (e.g., recoveries of prior year obligations). Execution of the budget includes the obligation of budgetary resources and the outlays to liquidate the obligations.
210. Borrowing authority is sometimes used instead of appropriations to incur obligations and make payments to liquidate them out of borrowed money. However, borrowing money under this authority does not change the net position of the entity. The liability created by the borrowing is recorded along with the related asset (the cash borrowed). Repayment of the liability later will normally require the use of an offsetting collection or an appropriation. Assets acquired as a result of borrowing may be later amortized or written off and become part of an entity's costs. When this occurs, or in the unusual event that the borrowing finances expenses rather than assets, the entity's net position will be reduced.

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211. Contract authority is not a reportable financing source because it only allows agencies to incur obligations in advance of receiving funds to pay for any resulting liabilities. The funds to liquidate any resulting liabilities will come from an appropriation or offsetting collections. For financial statement purposes, a financing source is recognized in accordance with the appropriate accounting standards for the type of financing received to liquidate the liability. Under past practice the financing was recognized at the time liabilities were incurred, but under the new standard the financing will not be recognized until liquidating appropriations are made available, which may be in the same reporting period as the liability is incurred or a later period.
212. Appropriations, including permanent indefinite appropriations, are the most widely used form of budget authority. When obligated by orders for, or receipt or provision of, goods, services, or benefits, they are reflected as obligations incurred.⁴⁴ When used, appropriations are accounted for as an inflow of resources (i.e., an other financing source) in calculating net results of operations for the reporting period.
213. From the budgetary perspective, appropriations include dedicated tax receipts, such as Social Security taxes and Highway Trust Fund excise taxes. From a proprietary perspective, on the other hand, unexpended appropriations do not include dedicated tax receipts, because these receipts are accounted for as nonexchange revenue. Therefore, appropriations used do not include dedicated tax receipts, thus avoiding double counting of these amounts as financing sources.
214. The accounting treatment for recognizing “appropriations used” as a financing source parallels the budgetary accounting for expended appropriations. Expended appropriations are recognized when goods and services ordered have been delivered, when benefits are payable to recipients, or when funds available under a grant agreement are payable, and there is an available appropriation to pay these amounts. Under this standard, this is also the time when “appropriations used” is recognized as a financing source in the proprietary accounts.

⁴⁴Amounts appropriated to liquidate contract authority or repay debt are not available to incur new obligations and hence are not considered budget authority.

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215. Thus, at the time a liability is established which will be paid by an available appropriation, appropriations are considered used. Liabilities should be established in accordance with SFFAS No. 5. Under that standard, a liability can be established in several ways, and the type of transaction that has occurred governs when a liability has occurred. For example, grants can be provided under different transactions. Some can be provided without any required exchange of service with the federal government, while others may require specific activities to occur before the funds are available.
216. Providing funds from an appropriation does not necessarily cause the recognition of a financing source if that payment is an advance. For example, an entity may advance funds to a grantee under the grant agreement. This should not cause recognition of a financing source. The recognition of appropriations used would not occur until the grantee meets the requirements that allow it to use the funds in accordance with the grant agreement.
217. The focus on net cost rather than on matching financing with expenses as incurred provided an opportunity to simplify the accounting for appropriations and to eliminate one of the differences between financial and budgetary accounting. Reporting entities will no longer have to defer recognition of appropriations used nor accrue appropriations before they become available.
- Recognition was previously deferred for appropriations used to finance capitalized transactions, such as the purchase of a fixed asset or the making of a loan under pre-credit reform programs which have not converted their accounts to a present value basis. The use of financing was previously recognized at the same time and rate that depreciation of the asset's cost was recognized as an expense or that bad debts expense was recognized on pre-credit reform receivables which had not been converted to present values.
 - Accrual of appropriations as amounts receivable was sometimes allowed for costs incurred but not funded until after the period the costs were incurred, such as subsidy reestimates under the Credit Reform Act. Reestimates of subsidy cost for credit programs are made at or after the end of a period for which the reestimate applies and for which an expense is recognized, but the permanent indefinite authority is not available until the following period. When a financing accrual was not used for

unfunded expenses, the unfunded expenses were removed from cumulative results of operations and reported separately in net position as future funding requirements.

218. These changes eliminate reporting invested capital and future financing sources in equity. These two equity accounts did not provide accurate information because invested capital was never expected to be returned and future financing requirements did not cover all future financing needed but only that amount which had been recognized as expenses.
219. An appropriation may provide an agency with the authority to obligate and expend earmarked receipts to which it is legally entitled and its offsetting collections. Most of these inflows of resources are classified and accounted for as either exchange or nonexchange revenue in accord with the accounting standards previously discussed. However, the relationship is not exact between these revenues and related new budget authority. For example, some offsetting collections are neither a revenue nor a financing source. They only change the form of a resource already reported on the Balance Sheet (e.g., funds received from the sale of an asset at book value). Some offsetting collections are credited to receipt accounts instead of expenditure accounts and cannot be obligated without specific appropriation. Some of these revenues are precluded from obligation in a fiscal year by a provision of law, such as a benefit formula that determines obligations, or by a limit on the amount of obligations that can be incurred. Amounts precluded from obligation are not counted as budget authority in that year.
220. By recognizing nonbudgetary resources, e.g., imputed financing and transfers, the financial statements of the entity will show how its recorded costs were financed by the budgetary resources of other entities as well as its own.
- (a) “Imputed financing” sources are reported to offset budgeted costs of another entity that applicable accounting standards impute to the reporting entity.⁴⁵ The imputing process recognizes these costs in the net cost of operations of the responsible entity.

⁴⁵Imputed financing sources may be reported to recognize imputed costs that have not yet been budgeted for other entities, such as for pensions and retirement health care.

By reflecting “imputed financing” in the changes in net position, the net position of the responsible entity is not affected and there is no double counting.

- (b) “Transfers-in” and “Transfers-out” are necessary to show transfers of assets or revenue from one Government entity to another. In the case of assets, the transferor’s budget reflected the original expenditure for the asset, but the budget normally does not reflect the subsequent transfer of the asset. The transfer changes the entity’s financial position at the time of transfer but not its net cost of operations. Therefore, it is recognized in determining the net results of operations for the reporting period but not net cost.

221. In the case of earned revenue, the budget may require the earned revenue inflow related to the entity’s costs to be paid to the General Fund or another entity. Reporting the transfer-out of such revenue as a reduction in net results of operations lets the responsible entity properly report its earnings in net cost of operations without increasing its net position.

222. Donations are not included as receipts in the budget, except for cash and near-cash items. However, some other kinds of donations are also recognized as revenue. Such revenues are permanent differences between the budget and the financial statements. Donation revenue will increase net results of operations under these standards. Under the standard, accounting for donations is consistent with current practice in the private sector where contributions are recognized as revenue.

223. Costs that are not yet covered by budgetary resources are “permanent” differences until Congress acts to finance them in the budget or until permanent budget authority becomes available. Under the new standards, financing yet to be provided for recorded costs will not be accrued. Accordingly, it will not increase cumulative results of operations.

Implications of the Term “Net Results of Operations”

224. Some of those who commented on the exposure draft expressed concern that some readers might infer that the amount of “net results of operations” reported on the new Statement of Changes in Net Position was a relevant performance measure. Some financial statement users might draw such an inference because, in the private

sector, the term “net results of operations” is synonymous with net income and net income is the “bottom line” performance measure. Similarly, the statement of operations used by federal reporting entities prior to implementation of SFFAS No. 7 focused on a similar bottom line, net results of operations. This was the result of showing the flow of all operating activities on a single statement. For most governmental entities, however, no single bottom line can accurately measure performance, and “net results of operations” normally provides little information on either the costs or the benefits of an entity’s operations.

225. The new reporting model, illustrated in Entity and Display, focuses on measuring costs and reporting on performance. Both gross and net cost are key financial performance measures that can be related to outputs and outcomes of the entity’s programs and activities.

Dedicated Collections

226. The exposure draft proposed disclosure requirements for trust funds that were included within the reporting entity’s financial statements in total and for material individual fund. The information was proposed to provide users a basis for understanding these funds and for holding the Government accountable for the use and disposition of earmarked collections. Based on comments received, this standard changes what was proposed as follows.
- A. The proposed standard did not cover funds administered by a federal entity in a fiduciary relationship with beneficiaries that were not included in the entity’s financial statement. In addition, it did not cover other funds which are of the same nature as many trust funds. The standard now requires disclosures for these funds also.
 - B. The requirement for a total for all funds was modified. If the fund is not material to the reporting entity, disclosure may be made in a special report to the contributors and beneficiaries (or their representatives) and only disclosure of the total of these funds is required.
227. **User needs.** Funds that account for dedicated collections are of great interest to users of federal financial statements. First and foremost are the contributors and beneficiaries to which the Government needs to be accountable for the receipt and disposition of earmarked

collections and for the balances that remain available to pay beneficiaries in the future or serve other purposes determined by law. Other users are interested in the financing of other government operations with these fund balances.

228. External users of federal financial reports sometimes misunderstand the relationship of these funds, especially trust funds, to the Government. Very few Government trust funds are held “in trust” in a fiduciary relationship as is customarily the meaning of this term outside the Government. Also, some of the trust funds currently spend less than the receipts they collect each year. Most of the cash surplus that arises when receipts are greater than outlays is invested in Treasury securities until the amounts are needed for the trust fund to use in accordance with benefit formulas or other provisions of the law.
229. The Treasury uses these additional receipts to meet the cash needs of general operations, thus reducing the need to borrow from the public, raise taxes, or reduce spending. In the consolidated financial statements of the Government, the investments in Treasury securities held by trust funds and other fund entities and the corresponding debt owed by the Treasury to these funds cancel out. They are eliminated from the amounts reported in the consolidated Balance Sheet but footnote disclosure of these amounts normally has been included.
230. **Funds covered by the standard.** As pointed out by respondents, trust funds are not the only type of fund that collects dedicated moneys. However, the exposure draft did not specifically delineate which funds might be included in the wider scope. The Board decided to limit these disclosures to funds where there was a need to show accountability to contributors and expected beneficiaries. Therefore, the funds that are covered by this standard are all trust funds, all special funds that are similar to trust funds, and all fiduciary funds whether or not in the budget.
231. The federal government does not use a consistent fund designation for these types of collections. Funds classified by law as trust funds are established by specific legislation to carry out activities stipulated by law and frequently are financed by taxes. While the Government’s use of the term “trust funds” ordinarily differs from use of the term in the private sector, a few trust funds within the federal universe have the stringent fiduciary characteristics similar to those of trust funds in the private sector. Furthermore, some funds within the budget are

classified as special funds and are similar in nature to non-fiduciary trust funds within the budget. Providing precise criteria for which non-trust funds are covered by this requirement is difficult. The Board realized that it will not always be easy for management to identify accountability expectations of contributors and beneficiaries.

232. On the other hand, no special accountability of a fund is needed for the sake of those who make voluntary payments in contemporaneous exchange for goods or services. Once goods and services have been rendered for the payment made, the purchaser generally does not expect the fund to provide additional accountability. For this reason the special reporting requirements do not apply to revolving funds or other funds financed similarly. However, special accountability may exist for a revolving fund that collects receipts for goods and services that are expected to be provided at a later period, such as long-term insurance contracts, and preparers are encouraged to provide the needed information in such cases.
233. **Funds not part of the reporting entity's financial statements.** In most cases, the requirement will apply to a fund that is included in the financial statements of the reporting entity. In the case of most fiduciaries, however, the fund is administered by a reporting entity but is not part of the reporting entity itself or included in its own general purpose financial statements. The disclosure requirement applies to such funds as well.
234. **Special reports.** Since the primary purpose of this requirement is accountability to the contributors and expected beneficiaries, all funds that meet the stated criteria are deemed material in this respect. Therefore, information needs to be provided regardless of whether it is material to the reporting entity. However, to minimize the amount of additional information required in financial statements, where the disclosures for dedicated collections are made to the contributors and beneficiaries in special reports and the information required is not material to the reporting entity, minimal disclosures are included in the reporting entity's general purpose financial statements or notes thereto. Special reports provided to representatives of contributors or beneficiaries may satisfy this requirement (for example, a report to an Indian tribal government).

Appendix B: Guidance For The Classification Of Transactions

Introduction

235. The Government of the United States has a great many types of transactions that finance its cost of operations, and they must be classified in various ways for revenue accounting in order to achieve the objectives of the standards in this Statement. The type of transaction may be an exchange transaction, a nonexchange transaction, or an other financing source; the transaction may be made between a Government reporting entity and the public or between two reporting entities within the Government (i.e., an intragovernmental transaction). If it is an exchange transaction, it will normally produce revenue but may produce gains and losses. This appendix provides guidance for the classification of specific transactions based on the standards for accounting for revenue and other financing sources, and the reasoning behind these standards as explained in the Introduction and the Basis for Conclusions.
236. To serve that purpose, this appendix provides guidance for classifying all major transactions that finance the Government's cost of operations and a significant number of lesser transactions. It is intended that these classifications—together with the explanation of these classifications, interpreted in the light of the Standards, the Basis for Conclusions, and the Introduction—will provide guidance for classifying all the financing transactions of the Government, including those that are not specifically listed. It should be understood that while some classifications are unequivocal, others are the result of balancing different considerations.
237. The transactions in this appendix are divided into several groups. Transactions recognized in the financial statements have a two-fold division: first, whether they are with the public or intragovernmental; and second, whether they are nonexchange transactions, exchange transactions that produce revenue, exchange transactions that produce gains or losses, or other financing sources. A separate group consists of gains and losses due to revaluation.

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238. Exchange transactions are classified as producing gains or losses if they are likely to be unusual or nonrecurring. If the transactions classified in this appendix as gains or losses are usual and recurring for a particular reporting entity, that entity should classify them as producing exchange revenue or expense instead of gains or losses.
239. The final group of transactions in this appendix consists of transactions that produce amounts not recognized as revenues, gains, or other financing sources. Although in some instances there is overlap with other groups, they are presented together as a convenient reference to amounts not classified in any of the other categories. They include:
- A number of transactions in which there is no net inflow of resources (or the net inflow is less than the full amount of the transaction) because one asset is exchanged for another or there is an increase in both assets and liabilities.
 - Certain transfers and donations that do not affect net cost or net position.
 - A number of transactions involving direct loans and loan guarantees, which are recognized as expenses or reductions in expenses according to the standards in SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees.
 - Deposit fund transactions.
240. As a guide to this appendix, the following table lists in order the transactions that are illustrated, group by group, and cites the page. Unless otherwise stated:
- Revenue from nonexchange transactions is included in determining the net operating results and hence the change in net position.
 - Revenue from exchange transactions is subtracted from gross cost in determining the net cost of operations. (Gains and losses from exchange transactions also affect net cost.)
 - Other financing sources are included in determining the net operating results and hence the change in net position.
241. In addition, the collection and disposition of most nonexchange revenue and a small part of exchange revenue is accounted for as a custodial activity of the collecting entity.

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Transactions With The Public

Nonexchange transactions with the public

242. Individual income taxes, corporation income taxes, social insurance taxes and contributions,⁴⁶ excise taxes, estate and gift taxes, and customs duties.—Taxes (including customs duties) are levied through the exercise of the power of the Government to compel payment. In broad terms, taxes are “the price we pay for civilization.” More specifically they finance spending of many types to promote the general welfare, provide for the common defense, and ensure domestic tranquillity: national defense, a judicial system, aid to the elderly, construction of infrastructure, education and training, and so forth. The relationship between the tax paid and the value received is too indirect and disproportionate to relate the revenue that is received

⁴⁶“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans. “Social insurance” taxes and contributions do, however, include payments made by or on behalf of Federal employees to social insurance plans, such as Social Security and Medicare.

from any identifiable taxpayer to the cost that is incurred for providing that identifiable taxpayer with benefits. This is especially the case where the benefits are of a collective or public nature, such as national defense, in which case consumption by one taxpayer does not reduce the consumption available for another; or where the benefits are designed to redistribute income from one group of people to another. Therefore, tax revenue is nonexchange revenue.

243. All excise taxes, like other taxes, are classified as resulting in nonexchange revenue. Some excise taxes (considered to be benefit taxes) are levied on bases that are related to the use of publicly provided goods and services or the public provision of other benefits, such as the gasoline tax; certain other excise taxes are levied on bases related to a cause of some damage and are dedicated to pay down costs, such as the tax on domestically mined coal, which is dedicated to the black lung disability trust fund. Even in these cases, however, the relationship between the tax and the benefit received by an identifiable recipient is relatively indirect and disproportionate. Moreover, these excise taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Therefore, like other taxes, they are classified as producing nonexchange revenue.
244. Board members have differing views on whether social insurance programs result in exchange or nonexchange transactions.⁴⁷ However, they agree that social insurance tax revenue should be reported in the same way as other tax revenue for the purposes of financial reporting. This is because social insurance taxes, like other taxes, are determined through the exercise of the power of the Government to compel payment. Furthermore, individuals and businesses subject to social insurance taxes are subject to them as a byproduct of their decision to enter covered employment or engage in a covered business, so especially for the major, broad-based social insurance programs—Social Security, Medicare (hospital insurance), and unemployment compensation—they have virtually no legal option except to pay.

⁴⁷[See discussion of social insurance programs in FASAB, Exposure Draft, Supplementary Stewardship Reporting \(August 1995\).](#)

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245. Tax receipts are generally collected from the public by the IRS (Internal Revenue Service) and, to a lesser extent, by the Customs Service and other entities acting as agents for the recipient entities rather than on their own behalf. The collecting entity receives the cash and then transfers it to the General Fund, trust fund, or special fund on whose behalf it was collected. The amount so collected should be accounted for as a custodial activity by the collecting entity. The tax is recognized as a nonexchange revenue by the entity that is legally entitled to the amount. This would be a trust fund or special fund in the case of an earmarked (i.e., dedicated) tax. If collected on behalf of the Government as a whole, it would be recognized in the Government-wide consolidated financial statements.
246. Social insurance taxes and contributions paid by Federal employees.⁴⁸—Federal employees may be covered by social insurance programs such as Social Security⁴⁹ and Medicare under the same terms and conditions as the remainder of the covered population. The payments made by Federal employees are in the nature of taxes, compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to employees of the United States government, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employee contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have obtained similar benefits. For these reasons, the employee contribution should have the same classification as contributions by non-Federal employees, which is nonexchange revenue.
247. Deposits by states for unemployment trust fund.—States deposit the receipts from the state unemployment tax to the U.S. Treasury for the unemployment trust fund in order to finance most of the benefits

⁴⁸“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

⁴⁹Most Federal civilian employees hired before 1984 are not covered by Social Security.

under the unemployment compensation system. The state unemployment tax differs from state to state in terms of the tax rate, tax base, and certain other characteristics, and unemployment benefits also differ from state to state. Nevertheless, the deposit has long been construed as a Federal budget receipt (a governmental receipt), and the unemployment trust fund has long been included as an account in the Federal budget.

248. This is for a combination of reasons taken together: (a) the unemployment compensation system—including the system of taxes, the system of benefits, and the trust fund—was established by the Social Security Act of 1935 and has been amended by Federal law many times; (b) deposits are held in a trust fund operated by the U.S. Government; (c) Federal law specifies extensive requirements for the state unemployment tax and unemployment benefits; (d) the Federal unemployment tax finances grants to states to cover their entire cost of administering the unemployment system; and (e) Federal law effectively coerces states to participate in the system, with participation requiring them to levy the state unemployment tax and deposit the collections in the U.S. Treasury. If a state does not participate (or is not certified by the Department of Labor as meeting Federal requirements): (i) the Federal unemployment tax is levied within the state at its maximum rate, (ii) the system does not pay any unemployment compensation benefits within the state, and (iii) the Federal Government provides no grants to state governments to pay for the costs of administration. The deposits of the state tax are therefore nonexchange revenue of the unemployment trust fund. (The Federal unemployment tax is levied and collected separately from the state unemployment tax.)
249. User fees, Harbor Maintenance trust fund. —This is an example of a tax that is termed a “user fee” by law while classified in the budget as a governmental receipt together with other taxes and duties. It is an ad valorem tax of 0.125 percent imposed on commercial cargo loaded and unloaded at specified U.S. ports open to public navigation. The receipt is earmarked to the Harbor Maintenance trust fund. It is similar in nature to other excise taxes that result from the Government’s power to compel payment and that are dedicated to a trust fund or special fund to be spent for a designated purpose (for example, the gasoline excise tax, which is dedicated to the Highway Trust Fund). It therefore should be recognized as nonexchange revenue by the Harbor Maintenance trust fund.

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250. Customs Service fees.—The Customs Service collects revenue primarily from duties on imported merchandise but also from two types of fees: the merchandise processing fee and a group of fees called “user fees.”
251. The merchandise processing fee is primarily an ad valorem charge on formal merchandise entries into the United States (at 0.19 percent) subject to a maximum and minimum charge. It also includes flat fees on informally entered goods. The collections are earmarked by law to a special fund from which receipts are made available to finance Customs Service operations to the extent provided by current appropriations.
252. The merchandise processing fee is associated with the cost of the Customs Service’s operations. The fee as originally enacted was modified by the Customs and Trade Act of 1990 to make it consistent with U.S. obligations under GATT (the General Agreement on Tariffs and Trade) after a GATT panel had ruled that the original fee (a straight ad valorem fee) exceeded the cost of services rendered and was a tax on imports that discriminated against imports in favor of domestic production. The maximum and minimum fees and the flat fees were enacted to meet the U.S. obligation.
253. However, the associated cost is primarily some of the costs of assessing and collecting duties on imported merchandise, such as the salaries of import specialists (who classify merchandise) and the costs of processing paperwork. The importer pays duties that are required by law; it does not receive anything of value from the Government in the nature of an exchange. Furthermore, these costs are not likely to depend significantly on the value of the merchandise, and the fee is levied through the power of the Government to compel payment. Therefore, for the purpose of a classification system for financial reporting, the fee is akin to dedicated taxes that are also related in the aggregate to associated costs and that are classified as nonexchange revenue (e.g., the excise tax on gasoline). The merchandise processing fee is therefore classified as a nonexchange revenue.
254. The user fees consist of a group of flat fees charged on passengers and conveyances entering the country.⁵⁰ The collections are dedicated by

⁵⁰These fees are sometimes called the “COBRA user fees.” This term comes from the Consolidated Omnibus Budget Reconciliation Act of 1985, which established these fees.

law to a special fund whose receipts are made available by permanent indefinite appropriation to finance Customs Service operations.

255. These fees are intended to offset certain inspection costs that relate to the processing of passengers and conveyances entering the country. They are levied through the power of the Government to compel payment, and the person or entity that pays these fees does not receive anything of value from the Government in exchange. The inspection activities are for a variety of purposes: to ensure that dutiable merchandise is declared, to seize contraband (such as narcotics and illegal drugs), to detect infringements of patent and copyright laws, and so forth. Some of these purposes are related to the Government's powers to raise taxes, which are nonexchange revenue, and to enforce laws. Only to a limited extent are they like regulatory user fees, based on the Government's power to regulate particular businesses or activities. Therefore, like the merchandise processing fee, the user fees are classified as nonexchange revenue.
256. Deposits of earnings, Federal Reserve System.—The Federal Reserve System consists of the Board of Governors of the Federal Reserve System and twelve regional Federal Reserve Banks. Under Federal accounting concepts, it is not considered to be part of the Government-wide reporting entity. Therefore, payments made to or collections received from the Federal Reserve System would be reported in the financial statements of the Federal Government and its component reporting entities.⁵¹ The Federal Reserve earns large amounts of interest on its portfolio of Treasury securities and deposits to the Treasury all net income after deducting dividends and the amount necessary to bring the surplus of the Federal Reserve Banks to the level of capital paid-in.
257. The Federal Reserve was established by Act of Congress pursuant to the Government's sovereign power over the nation's money, and its investment in Treasury securities is necessary for carrying out its monetary function. It does not receive anything of value from the Government in exchange for its deposit of earnings, and on occasion it has been required by law to make extra payments. The revenue from the deposits is therefore nonexchange.

⁵¹SFFAC No. 2, Entity and Display, para. 47.

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258. Donations: except types of property, plant, and equipment that are expensed.—Donations are contributions to the Government, i.e., voluntary gifts of resources to a Government entity by a non-Federal entity.⁵² The Government does not give anything of value to the donor, and the donor receives only personal satisfaction. The donation of cash, other financial resources, or nonfinancial resources (except stewardship property, plant, and equipment) is therefore a nonexchange revenue.
259. The exception, stewardship PP&E, consists of Federal mission PP&E, heritage assets, and stewardship land. Such PP&E is expensed if purchased, but no amount is recognized if it is received as a donation.⁵³ Correspondingly, no revenue is recognized for such donations.
260. Fines and penalties.—Fines and penalties are monetary requirements imposed on those who violate laws or administrative rules. The person or other entity that pays a fine or penalty does not receive anything of value in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through the exercise of its power to compel payment. Fines and penalties are therefore a nonexchange revenue.
261. Fines from judicial proceedings are collected by the entity acting as an agent for the Government as a whole rather than on its own behalf. They are therefore accounted for as a custodial activity of the collecting entity and recognized as a nonexchange revenue in the Government-wide consolidated financial statements.
262. Fines and penalties produced by an entity's operations—such as inspections to ensure compliance with Federal law and with regulations that are the responsibility of the entity (e.g., inspections by the Office of Surface Mining) or compliance with regulations for the conduct of a Federal program—are recognized as nonexchange revenue by whichever entity is legally entitled by law to the revenue. In some cases, but not all, this would be the collecting entity. If the

⁵²The term “donations” includes wills disposing of property and judicial proceedings other than forfeitures.

⁵³SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 61 and 71.

collecting entity transfers the nonexchange revenue to the General Fund or another entity, the amount is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.

263. Penalties due to delinquent taxes in connection with custodial activity.—The person or other private entity that pays a penalty on delinquent taxes does not receive anything in exchange, nor does the Government sacrifice anything of value. The Government collects these amounts through its power to compel payment. Penalties on delinquent taxes are therefore a nonexchange revenue. The penalties are accounted for as a custodial activity. If transferred to the General Fund, the penalties are recognized as nonexchange revenue in the Government-wide consolidated financial statements; if transferred to another entity, they are recognized as nonexchange revenue by the entity that receives the transfer.
264. Forfeitures.—Property may be seized as a consequence of various laws and regulations and forfeited to the Government. Forfeited property may be acquired through forfeiture proceedings, be acquired to satisfy a tax liability, or consist of unclaimed and abandoned merchandise. Forfeited property is principally managed by the Asset Forfeiture Fund of the Justice Department and the Treasury Forfeiture Fund of the Treasury Department. Revenue is recognized from forfeited property unless the property is distributed to state or local law enforcement agencies or foreign governments or is received in satisfaction of a previously recognized revenue (e.g., accrued tax receivables).⁵⁴
265. The timing of revenue recognition depends on how the property is forfeited and the nature of the property. In the case of unclaimed and abandoned merchandise, revenue is recognized in the amount of the sales proceeds at the time the property is sold. In the case of property acquired through forfeiture proceedings, the timing of recognition depends on the nature and disposition of the property. For monetary

⁵⁴This amends SFFAS No. 3, Accounting for Inventory and Related Property, with respect to forfeitures related to satisfying tax liabilities.

instruments, the revenue is recognized at the time of obtaining forfeiture judgment; for property that is sold, at the time of sale; and for property that is held for internal use or transferred to another Federal agency, at the time of obtaining approval to use the property internally or transfer it.⁵⁵

266. The method of measuring revenue depends on the nature of the property. The amount of revenue recognized for monetary instruments is the market value when the forfeiture judgment is obtained. For property that is sold, it is the sales proceeds. For property that is held for internal use or transferred to another Federal agency, it is the fair value of the property less a valuation allowance for any liens or third party claims.
267. The revenue from forfeiture is nonexchange revenue, because the Government seizes the property through the exercise of its power. The Government does not sacrifice anything of value in exchange and the entity that forfeits the property does not receive anything of value. More than half of the forfeiture revenue of the two funds mentioned above is from currency and other monetary instruments. Although other types of forfeited property must be sold in order to recognize revenue, or constructively sold (if transferred to another Federal agency or placed into internal use), this is the last step in a process that is inherently nonexchange.
268. The disposition of the revenue from forfeiture is determined by law. Revenue or the property itself may ultimately be distributed to the seizing entity, state or local law enforcement agencies, foreign governments, or the general fund. Revenue is recognized as nonexchange revenue by the entity that is legally entitled to use the revenue or to use the property itself. If the property is distributed to a state or local law enforcement agency or a foreign government, revenue is not recognized by a Federal Government reporting entity. If the revenue is transferred to the General Fund, it is recognized as

⁵⁵SFFAS No. 3, para. 57-78. The standard also requires deferred revenue to be recognized when a forfeiture judgment is obtained, but the deferred revenue is reversed when revenue is recognized. The amount of revenue ordinarily differs from the amount of deferred revenue. In some cases, an adjustment subsequent to the original forfeiture judgment may be necessary when it is later determined that a portion of the forfeiture is to be distributed to state or local law enforcement agencies or foreign governments.

nonexchange revenue in the Government-wide consolidated financial statements.

269. Some entities may be involved in the management and liquidation of forfeited property but not themselves be entitled to the revenue or to the use of the property. For example, a central fund created to support the seizure activities of multiple entities may manage forfeited property and the collection and disposition of the revenue from that property. These entities should account for the property as a custodial activity. Revenue is shown when it is recognized, and it is shown as transferred to others when the cash is disbursed or the property is delivered. The disposition of property to an entity outside the Federal Government is also accounted for.

Exchange transactions with the public: revenue

270. Sales of goods and services.—The cost of production for goods and services such as electricity, mail delivery, and maps is defrayed in whole or in part by revenue from selling the goods or services provided. The sales may be made by a public enterprise revolving fund (such as the Bonneville Power Administration), an intragovernmental revolving fund (such as the Government Printing Office), or a fund that is not a revolving fund (such as the Geological Survey). Each party receives and sacrifices something of value. The sale is therefore an exchange transaction, and the revenue is exchange revenue for the entity making the sale.

271. Sales of goods and services in undercover operations.—The cost of the Government's undercover operations is defrayed in whole or in part from the proceeds of sales of goods that have been purchased (as opposed to goods that have been forfeited). Each party receives and sacrifices something of value. These characteristics of the transaction are not affected by whether the sale is illegal. The sale is therefore an exchange transactions, and the revenue is exchange revenue of the entity making the sale.

272. Interest (unless classified elsewhere), dividends, and rents (except for mineral rights) on Government property.—Each party receives and sacrifices something of value, so the inflow of resources is an exchange transaction.

273. Interest is classified as exchange revenue notwithstanding the fact that the entity may not be charged a cost of capital for the assets that yield these inflows; or, if the entity borrowed from Treasury to acquire

the assets, it may have been charged a below-market interest rate. The gross cost of the entity is understated in such cases; and to recognize an exchange revenue is to recognize a revenue without some or all of the related costs, and hence to understate the entity's net cost of operations. Nevertheless, in some cases the entity does pay the Treasury at least some interest; and the Government's cost of borrowing to acquire the assets is recognized as a cost of the Government as a whole. Since some cost is recognized, even if not always the full cost of the entity,⁵⁶ an exchange revenue is recognized for the entity that receives the inflow of interest.

274. Rents, royalties, and bonuses on Outer Continental Shelf (OCS) and other petroleum and mineral rights.—Rents, royalties, and bonuses are exchange revenues, because each party receives and sacrifices something of value. The amounts are earned by sales in the market and therefore are exchange revenue. They are collected by the Minerals Management Service (MMS) of the Department of the Interior, which manages the energy and minerals resources on the OCS and collects the amounts due the Government and Indian tribes from minerals produced on the OCS and other Federal and Indian lands.
275. MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards natural resources are not recognized as an asset and depletion is not recognized as a cost. As a result, this exchange revenue bears little relationship to the recognized cost of MMS and cannot be matched against its gross cost of operations. Therefore, although the inflows are exchange revenue, they should not be subtracted from MMS's gross cost in determining its net cost of operations.
276. MMS should instead account for the exchange revenue as a custodial activity. MMS collects rents, royalties, and bonuses acting as an agent on behalf of the recipients designated by law: the General Fund, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. The amounts of revenue should be recognized and measured under the exchange

⁵⁶The partial recognition of associated cost distinguishes interest from rents, royalties, and bonuses on the Outer Continental Shelf and the auction of the radio spectrum. For the latter transactions, see the subsequent paragraphs.

revenue standards when they are due pursuant to the contractual agreement.

277. The rents, royalties, and bonuses transferred to Treasury for the General Fund, or to other Government reporting entities, should be recognized by them as exchange revenue. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, this exchange revenue should not offset their gross cost in determining their net cost of operations. It should instead be a financing source in determining their operating results and change in net position.
278. Proceeds from the auction of the radio spectrum.—The proceeds from auctioning the right to use the radio spectrum are exchange revenues, because each party receives and sacrifices something of value. The amount of revenue is earned by sales in the market at auctions. It bears little relationship to the costs recognized by the Federal Communications Commission (FCC), which collects the revenue, or to the costs recognized by the U.S. Government as a whole. Therefore, it should not be offset against the costs of the FCC in determining its net cost of operations or against the costs of the Government as a whole in Government-wide consolidated financial statements.
279. The FCC should therefore account for this exchange revenue as a custodial activity, acting as an agent on behalf of the General Fund; and it should be included as exchange revenue in the Government-wide consolidated financial statements.
280. Interest on post-1991⁵⁷ direct loans.⁵⁸—Interest on direct loans is an exchange transaction, because it is part of a broader exchange transaction in which the entity makes a loan to the borrower and the entity and borrower each receives and sacrifices something of value.

⁵⁷Post-1991 direct loans consist of direct loans that were obligated after September 30, 1991, whereas pre-1992 direct loans consist of direct loans that were obligated before October 1, 1991. The same accounting that is used for post-1991 direct loans is also used for pre-1992 direct loans that were modified and transferred to financing accounts; loans receivable arising from defaulted post-1991 guaranteed loans; and loans receivable arising from defaulted pre-1992 guaranteed loans that were modified and transferred to financing accounts.

⁵⁸For interest on pre-1992 direct loans, see the preceding section on “interest (unless classified elsewhere) . . .”

Interest on direct loans that are budgeted according to the provisions of the Federal Credit Reform Act of 1990 consists of two components: the nominal interest (the stated interest rate times the nominal principal) and the amortized interest (change in present value of the loans receivable due to the passage of time). The combined effect of these components equals the effective interest, which is directly defined as the present value of the loans receivable times the Treasury interest rate applicable to the particular loans (i.e., the interest rate used to calculate the present value of the direct loans when the direct loans were disbursed). The effective interest causes an equal increase in the aggregate value of the assets on the balance sheet, and therefore the effective interest is the amount recognized as exchange revenue.⁵⁹

281. Interest on delinquent taxes and other receivables that arise as the result of custodial operations.—Receivables that arise as the result of custodial operations are custodial (or non-entity) assets, held by the IRS or another entity as an agent for the Government as a whole rather than on its own behalf (e.g., IRS tax receivables on which the delinquent taxpayer must pay interest). The interest is an exchange revenue, because each party receives and sacrifices something of value, but it is not related to the costs incurred by the collecting entity. The interest is accounted for as a custodial activity by the collecting entity. If transferred to the General Fund, the interest is recognized as exchange revenue in the Government-wide consolidated financial statements because it is related to the government's cost of borrowing; if transferred to another entity, it is recognized as nonexchange revenue by the entity that receives the transfer.
282. Regulatory user fees such as patent and copyright fees; immigration and consular fees; SEC registration and filing fees; and Nuclear Regulatory Commission fees.—Regulatory user fees are charges based on the Government's power to regulate particular businesses or activities. The revenue is related to the cost in one of two ways. Special benefits may be provided to identifiable recipients who pay the fees, beyond the benefits, if any, that accrue to the general public (e.g., passport fees); or the Government may incur costs in order to regulate an identifiable entity for the benefit of the general public or some other group, in which case the user charge compensates the

⁵⁹See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, paragraphs 30-31 and 37; for an illustrative case study, also see Appendix B.

Government for its regulatory costs that were caused by the activity of the party that pays the charge (e.g., SEC and Nuclear Regulatory Commission fees). Because in general the revenue is closely related to the cost of operations, these fees are classified as exchange transactions and the revenue is an exchange revenue of the entity that charges the fee.

283. Diversion fees, Department of Justice.—Registrants in the Diversion Control Program (e.g., physicians) pay fees to the Drug Enforcement Administration, in exchange for which the DEA provides the registrants with the authority to prescribe controlled substances. The diversion fees are intended to cover the costs of the Diversion Control Program. Because the revenue is related to the cost and the registrants both receive and sacrifice value, the payment of these fees is an exchange revenue of the Diversion Control Program.
284. Premiums for SMI (Supplementary Medical Insurance), bank deposit insurance, pension benefit guarantees, crop insurance, life insurance, and other insurance.—In exchange for a premium and other considerations, the Government promises to make payments to program participants if specified events occur. The premium offsets the cost of the program in whole or in part. The degree to which participation is voluntary differs from program to program. Because the revenue is related to the cost of the providing service, it is an exchange revenue of the insurance program.
285. Federal employee contributions to pension and other retirement benefit plans.⁶⁰—Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary) and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government promises a pension to its employees after they retire. The Government also promises other retirement benefits, notably health benefits. In return, the employee provides services and, under some plans, makes a contribution to the retirement fund out of his or her

⁶⁰Federal employee retirement plans do not include social insurance, such as Social Security and Medicare.

salary. The financing of these benefits may include contributions paid by the employee to the retirement fund.

286. In broad terms, the employee contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More narrowly, it is a payment by the employee as part of an exchange of money and services for a future pension or other retirement benefit. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.⁶¹
287. Federal employee contributions to health benefits plan for current coverage.—Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of its employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of the employees.
288. In broad terms, the employee contribution out of his or her salary is an inflow of resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage by a health benefits plan. Therefore, it is an exchange revenue of the entity that administers the health benefits plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.
289. Reimbursement for collecting revenue.—The Customs Service collects duties on goods imported by Puerto Rico and the Virgin Islands. The Customs Service retains an amount equal to the estimated cost of collecting these duties, including all costs of operations in Puerto Rico

⁶¹For further discussion of the accounting standards for pensions and other retirement benefits of Federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

and the Virgin Islands and an allocation of overhead; it transfers the remainder to the Treasury, which, in turn, transfers the collections to Puerto Rico or the Virgin Islands.

290. The total amount of duties collected on these goods should be accounted for as a custodial activity by the Customs Service. Notwithstanding that duties are a nonexchange revenue, these particular duties are a nonexchange revenue of an entity other than the United States and therefore are not recognized as a nonexchange revenue of the U.S. Government.
291. The method of disposing of these collections combines two distinct transactions into one. The entire amount of the duties could be transferred to Puerto Rico and the Virgin Islands, and these governments could then pay the Customs Service to reimburse it for its services of collecting duties. The payment to Customs would be exchange revenue of the Customs Service. The actual procedure for reimbursement, whereby Customs retains an amount equal to the estimated cost, is simpler but equivalent in substance. Hence, the custodial transfer to Treasury (for Puerto Rico and the Virgin Islands) and the amount retained by Customs should be shown as separate components of the disposition of the revenue from customs duties. The amount retained by Customs to reimburse itself for its costs is exchange revenue of the Customs Service and is offset against its gross cost in calculating its net cost of operations.
292. Reimbursement for cleanup costs.—The Coast Guard or other Federal entities may incur costs to clean up environmental hazards caused by private parties and, in some cases, require these private parties to reimburse it for the costs incurred. Notwithstanding that the Government demands the revenue under its power to compel payment, the revenue arises from the action of the private parties and is closely related to the cost of operations incurred as a result of that action. Therefore, the revenue is an exchange revenue of the entity that incurs the cost.

Exchange transactions with the public: gains and losses

293. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.

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294. Sales of Government assets: other than property, plant, and equipment and forfeited and foreclosed property.—The sale of Government assets (other than property, plant, and equipment and forfeited and foreclosed property) is an exchange transaction, because each party receives and sacrifices something of value. If the sales price equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than the book value of the property, a gain or loss, respectively, is recognized to the extent of the difference. The amount of the difference between sales price and book value is ordinarily a gain or loss rather than a revenue or expense, because sales of property are ordinarily an unusual or nonrecurring inflow of resources.
295. Sales of property, plant, and equipment.— The transaction is an exchange transaction, because each party receives and sacrifices something of value. If the sales price⁶² equals book value, there is no gain or loss, because a cash inflow equal to book value is the exchange of one asset for another of equal recorded value and therefore not a net inflow of resources. If the sales price is more or less than book value, a gain or loss, respectively, is recognized to the extent of the difference. The amount of the difference is ordinarily a gain or loss rather than a revenue or an expense, because sales of property, plant, and equipment are ordinarily an unusual or nonrecurring inflow of resources.
296. The entire sales price is a gain if the book value of the asset is zero. The book value is zero (a) if the asset is general property, plant, and equipment (PP&E) that is fully depreciated or written-off or (b) if the asset is stewardship PP&E, for which the entire cost is expensed when the asset is purchased.⁶³

⁶²The sales price may include the fair value of items received in exchange.

⁶³SFFAS No. 6, Accounting for Property, Plant, and Equipment, has divided property, plant, and equipment (PP&E) into two basic categories: general PP&E and stewardship PP&E (which consists of federal mission PP&E, heritage assets, and stewardship land). General PP&E is capitalized and recognized on the balance sheet; stewardship PP&E is expensed and thus has no book value. (Stewardship PP&E is presented in a stewardship statement.)

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297. Acquisition of property, plant, and equipment through exchange.—The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).
298. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss.⁶⁴ It is a gain or loss rather than a revenue or expense, because ordinarily the amount would be an unusual or nonrecurring inflow of resources.
299. If the fair value of the PP&E acquired is less than the fair value of the PP&E surrendered, the PP&E acquired is recognized at its cost and subsequently reduced to its fair value. The difference between the cost of the PP&E acquired and its fair value is recognized as a loss.⁶⁵
300. Sales of foreclosed property: associated with pre-1992 direct loans and loan guarantees.—Foreclosed property associated with pre-1992 direct loans and loan guarantees is recognized as an asset at net realizable value. The sale is an exchange transaction, and any difference between the sales proceeds and book value is recognized as a gain or loss.⁶⁶
301. Sales of receivables: except direct loans.—The transaction is an exchange transaction, because each party receives and sacrifices something of value. Upon sale, any difference between the sales proceeds and book value is recognized as a gain or loss. If the sales price equals book value, there is no gain or loss, because the exchange of one asset for another of equal value is not a net inflow of resources.

⁶⁴See SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 32.

⁶⁵Ibid., footnote 38.

⁶⁶See SFFAS No. 3, Accounting for Inventory and Related Property, para. 79-91.

302. Sales of direct loans.—The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990, regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.⁶⁷ Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.⁶⁸
303. Retirement of debt securities prior to maturity.—Debt securities may be retired prior to maturity if they have a call feature or if they are eligible for redemption by the holder on demand. Many Treasury bonds issued before 1985 are callable; savings bonds, the Government account series, the foreign series, and the state and local series of Treasury securities are redeemable on demand, although sometimes with a penalty or other adjustment or only after a specified period of time.
304. Each party receives and sacrifices something of value in buying and selling debt securities that may be retired prior to maturity. The sales price reflects such features. Therefore, the transaction is an exchange transaction. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt is recognized as a loss or gain.⁶⁹
305. Seigniorage.—Seigniorage is the face value of newly minted coins less the cost of production (which includes the cost of the metal, manufacturing, and transportation). It results from the sovereign power of the Government to directly create money and, although not an inflow of resources from the public, does increase the Government's net position in the same manner as an inflow of

Other financing sources
from the public

⁶⁷This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is made and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

⁶⁸See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, para. 53-55 and Appendix B, Part II(B).

⁶⁹SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 54.

resources. Because it is not demanded, earned, or donated, it is an other financing source rather than revenue. It should be recognized as an other financing source when coins are delivered to the Federal Reserve Banks in return for deposits.

Intragovernmental Transactions

Nonexchange transactions—
intragovernmental: revenue

306. Interest on Treasury securities held by trust funds and special funds (except trust revolving funds).—Many trust funds and special funds hold Treasury securities on which they receive interest. In most cases the invested balances of these funds derive predominantly from the funds' earmarked taxes, which are nonexchange transactions with the public (e.g., employment taxes and gasoline taxes), and to a lesser extent from other financing sources received from other government entities (e.g., the General Fund payment appropriated to the Supplementary Medical Insurance fund). The balances are not earned in exchange transactions by the entity's operations. Most fundamentally, they are not produced by operations in which the entity incurs a cost.
307. Therefore, in such cases, the interest on Treasury securities should not be deducted from the gross costs of the trust fund (or special fund), or the organization in which it is administered, in determining its net cost of operations. As a result, that interest should not be classified as exchange revenue. It should instead have the same classification as the predominant source of the invested balances, which for most trust funds (and special funds) is nonexchange revenue. The interest received from invested balances of trust funds and special funds (except trust revolving funds) is therefore normally a nonexchange revenue.
308. The source of balances for some trust funds and special funds may not be predominantly nonexchange revenue. For example, the main source of balances for two major trust funds, the Civil Service Retirement and Disability fund and the Military Retirement fund, consists of exchange revenue and other financing sources. In such exceptional cases, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant

source of balances—in these cases, as exchange revenue—rather than according to the normal rule.

309. Interest received by one fund from another.—One fund within the Government may borrow from another. For example, in 1983 the Old-Age and Survivors Insurance trust fund borrowed from the Disability Insurance and Hospital Insurance trust funds. When that occurs, the lending fund sacrifices interest from Treasury securities on its invested balances and instead receives interest from the borrowing fund on the amount of the loan. Since the predominant source of balances to the lending fund is the same regardless of whether it invests in Treasury securities or lends to another fund, the interest received from the other fund should be classified in the same way—as nonexchange or exchange revenue—as the interest received on Treasury securities.
310. Employer entity contributions to social insurance programs.⁷⁰—Federal employees may be covered by social insurance programs such as Social Security⁷¹ and Medicare under the same terms and conditions as the rest of the covered population. Intragovernmental contributions to social insurance programs such as Social Security and Medicare are nonexchange transactions, just as payments made by private employers to these programs are nonexchange transactions. Contributions by private employers are in the nature of taxes; i.e., compulsory payments demanded by the Government through the exercise of its power to compel payment. Insofar as the social insurance program applies to Federal employees, the terms and conditions are generally the same as the program for private employees. The employer and employee contributions are generally calculated in the same way; the employer entity contribution is not earned by the social insurance program; and the benefits are generally calculated in the same way. The employee does not obtain particular benefits under the plan from rendering service in Federal employment, because he or she would have been similarly covered by the program if privately employed and would have received similar benefits. For these reasons, the employer entity contribution should have the same

⁷⁰“Social insurance” does not include programs established solely or primarily for Federal employees, such as pension and other retirement plans.

⁷¹Most Federal civilian employees hired before 1984 are not covered by Social Security.

classification as private employer contributions, which is nonexchange revenue.

Nonexchange transactions—
intragovernmental: gains and
losses

311. Retirement of debt securities prior to maturity: trust funds and special funds (except trust revolving funds).—Treasury securities held by trust funds and special funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other Treasury securities held by these funds may also be callable or redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For trust funds (except trust revolving funds) and special funds, as explained elsewhere, the interest is normally but not always a nonexchange revenue.
312. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the trust fund or special fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.
313. Cancellation of debt.—The debt that an entity owes Treasury (or other agency) may be canceled by Act of Congress. The amount of debt that is canceled (including the amount of capitalized interest that is canceled, if any) is a gain to the entity whose debt is canceled and a loss to Treasury (or other agency). The purpose of borrowing authority is generally to provide an entity with capital rather than to finance its operations. Therefore, the cancellation of debt is not earned by the entity's operations and is not directly related to the entity's costs of providing goods and services. As a result, the cancellation is a nonexchange gain to the entity that owed the debt and a nonexchange loss to the lender.

Exchange transactions—
intragovernmental: revenue

314. Intragovernmental sales of goods and services by a revolving fund.—The cost of providing goods or services by a revolving fund is defrayed in whole or in part by selling the goods or services provided. Intragovernmental sales may be made by an organization that maintains either an intragovernmental revolving fund (such as the Defense Business Operations Fund) or a public enterprise revolving fund (such as the Postal Service). Each party receives and sacrifices something of value. The proceeds are an exchange revenue.
315. Intragovernmental sales of goods and services by a fund other than a revolving fund.—The cost of providing goods or services is defrayed in whole or in part by selling the goods or services provided. Each party receives and sacrifices something of value. The proceeds are an exchange revenue.
316. Employer entity contributions to pension and other retirement benefit plans for Federal employees.—Employees of the Federal Government provide service to their employer in exchange for compensation, of which some is received currently (the salary); and some is deferred (pensions, retirement health benefits, and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this transaction, the Government promises a pension and other retirement benefits (especially health benefits) to the employees after they retire. The financing of these benefits may include contributions paid by the employer entity to the retirement fund.
317. In broad terms, the employer entity contribution is an inflow of resources to the retirement fund as part of this exchange transaction. More narrowly, it is a payment by the employer entity in exchange for the future provision of a pension or other retirement benefit to its employees. Therefore, it is an exchange revenue of the entity that administers the retirement plan and thus is an offset to that entity's gross cost in calculating its net cost of operations.⁷²

⁷²For further discussion of the accounting standards for pensions and other retirement benefits for federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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318. Employer entity contributions to health benefit plans for current coverage of Federal employees.—Employees of the Federal Government provide services to their employer in exchange for compensation, of which some is received currently in the form of money (the salary); some is received currently in the form of payments to a third party (the employer entity contribution to the medical insurance plan for current coverage of the employees); and some is deferred (pensions and other retirement benefits). This is an exchange transaction, because each party sacrifices value and receives value in return. As part of this exchange transaction, the Government and its employees both contribute to a medical insurance plan that provides current coverage of its employees.
319. In broad terms, the employer entity contribution is an inflow of resources to the health benefits plan as part of this exchange transaction. More narrowly, it is a payment in exchange for current coverage of the employer entity's employees by a health benefits plan. Therefore, it is an exchange revenue of the entity that operates the health benefits plan and thus is an offset to that entity's gross cost in determining its net cost of operations.
320. Employer entity payments for unemployment benefits and workers compensation.—The employer entity recognizes a liability and an expense for Federal employees who are laid-off or injured on the job and are entitled under law to unemployment benefits or workers compensation, respectively.⁷³ The payment to the former or current employee is made by the unemployment trust fund (Department of Labor) in the case of unemployment benefits and by the special benefits fund (Department of Labor) in the case of workers compensation. Unemployment benefits are reimbursed by the former employer entity; and workers compensation costs are mostly charged back to the employer entity.
321. Since the costs are recognized by the employer entity and its payment to the unemployment trust fund or the special benefits fund reimburses these funds for the costs they incur, the amounts these funds receive from the employer entity are exchange revenues.

⁷³See SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 96 and para. 181, footnote 70.

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322. Interest on Treasury securities held by revolving funds.—A revolving fund conducts a cycle of business-type operations in which the expenses are incurred to produce goods and services that generate revenue, and the revenue, in turn, finances expenses. Revolving funds need capital in their operations and may invest some of that capital in Treasury securities. Since their holding of invested balances and the sale of goods and services are both integral to the funds' operations, the interest on the funds' securities is related to the funds' cost of operations just as is the revenue earned from selling goods and services. Furthermore, the source of the invested balances is predominantly revenue earned from their sales of goods and services, for which the funds incurred costs of operations when that revenue was earned. The interest they receive should therefore be classified in the same way as their revenue earned from selling goods and services and should likewise be deducted from gross cost in determining the net cost of operations. For this reason, interest earned by revolving funds should normally be classified as exchange revenue.
323. The source of balances for some revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.
324. Interest on Treasury securities held by trust revolving funds.—A trust revolving fund is a revolving fund that is also classified by law as a trust fund. Like other revolving funds, it earns exchange revenue, which is an offset to its gross cost. For example, the revenue that the Employees Health Benefit fund earns from contributions by Federal employees, annuitants, employer entities, and the Office of Personnel Management (OPM) is an offset to the insurance premiums that it pays to private firms. Trust revolving funds need capital in their operations, just like other revolving funds, the source of which is predominantly the revenue they have earned. When some of their capital is invested in Treasury securities, the interest is related to their cost of operations in the same way as the revenue earned from selling services. Furthermore, the source of the invested balances is predominantly revenue earned from the sales of services, for which they incurred costs of operations when the revenue was earned. The interest they receive should therefore be classified in the same way as the interest received by other revolving funds, which is exchange revenue.

325. The source of balances for some trust revolving funds may not be predominantly exchange revenue. For such exceptions, as explained in the Basis for Conclusions, the interest should be classified in the same way as the predominant source of balances rather than according to the normal rule.
326. Interest on uninvested funds received by direct loan and guaranteed loan financing accounts.—A guaranteed loan financing account holds uninvested balances as reserves against its loan guarantee liabilities and earns interest on these balances that adds to its resources to pay these liabilities. A direct loan financing account may hold uninvested balances to bridge transactions that are integral to its operations, such as when it borrows from Treasury to disburse direct loans prior to the time of disbursement; it earns interest on these balances to reflect the time value of money and thereby finance the interest it pays on its debt to Treasury. Thus, in both cases, the interest received by the financing account is earned through exchange transactions with Treasury and is an offset to the financing account's related costs of operations. The interest is therefore an exchange revenue of the financing account.
327. Interest received by Treasury.—Accounts or funds (including direct loan and guaranteed loan financing accounts) may be authorized to borrow from the Treasury or from the Federal Financing Bank (an entity within Treasury) or other sources. The interest that the entity pays on its borrowings is a cost to the entity and an inflow of resources to the Treasury. The Treasury may be deemed to have borrowed from the public to finance the outlays for which the entity borrowed, and thus to have incurred a corresponding interest cost of its own. The interest received by Treasury from the entity is therefore related to Treasury's cost of borrowing from the public and should be classified as an exchange revenue.
328. **Note:** As explained in the introduction to this appendix, transactions that are classified as producing gains or losses should instead be classified as producing revenue or expense if they are usual and recurring for a particular reporting entity.
329. Retirement of debt securities prior to maturity: revolving funds and trust revolving funds.—Treasury securities held by revolving funds and trust revolving funds are primarily issued in the Government account series, which can generally be redeemed on demand. Other Treasury securities held by these funds may also be callable or

Exchange transactions—
intragovernmental: gains and
losses

redeemable on demand. If these debt securities are retired before maturity, the difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a gain or loss by the fund that owned the securities. The gain or loss should be accounted for as a nonexchange gain or loss if the interest on the associated debt securities is classified as nonexchange revenue, and it should be accounted for as an exchange gain or loss if the interest on the associated debt securities is classified as exchange revenue. For revolving funds and trust revolving funds, as explained elsewhere, the interest is normally but not always an exchange revenue.

330. The difference, if any, between the reacquisition price and the net carrying value of the extinguished debt should be recognized as a loss or gain in accounting for interest on Treasury debt. The amount should be equal in absolute value but with the opposite sign to the gain or loss recognized by the revolving fund or trust revolving fund. The amount should be recognized as a gain or loss from exchange in order to offset it against the gross interest on Treasury debt in the Government-wide consolidated financial statements.

Other financing sources—
intragovernmental

331. Appropriations.—Appropriations—a form of budget authority—permit an entity to incur obligations and make payments and thus are a means of financing the entity’s cost. They are not otherwise related to the entity’s cost and therefore are not an offset to its gross cost in determining its net cost of operations. They are not earned by the entity’s activities, demanded by the entity, or donated to the entity. Therefore, appropriations provide an other financing source instead of a revenue.

332. More precisely, “appropriations used” is recognized as an other financing source in determining the entity’s operating results when the entity receives goods and services or provides benefits, grants, or other transfer payments. To avoid double counting, appropriations used are **not** recognized for the appropriation of earmarked revenues or other financing sources, which are already counted in determining the entity’s operating results. Appropriations that have been made available for apportionment but have not been used are recognized as “unexpended appropriations” in the entity’s capital.

333. Cost subsidies: difference between internal sales price (reimbursement) and full cost.—One entity may receive goods or

services from another entity without paying the full cost of the goods or services or without paying any cost at all. Other Federal accounting standards may require the receiving entity to recognize the full cost as an expense (or, if appropriate, as an asset). In these cases the difference between full cost and the internal sales price or reimbursement (sometimes called a “transfer price”) is an imputed cost to the receiving entity.⁷⁴

334. The financing of the imputed cost is also imputed to the receiving entity. Imputed financing is necessary so that the imputed cost does not reduce the entity’s operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the receiving entity does not earn the amount imputed or demand its payment.

335. Cost subsidies: difference between the service cost of pensions (and other retirement benefits), less the employee contributions, if any, and the employer entity contributions.—The service cost of pensions (and other retirement benefits) to the employer entity, less the employee contributions, if any, is recognized as a cost to the employer entity. The difference between the employer entity’s cost and its contributions, if any, is imputed to the employer entity as part of its recognized cost. For pensions, the cost recognized by the employer entity is more than its contribution for employees who are covered by the Civil Service Retirement System and several minor systems (in a few of which the employer entity does not make any contributions toward the service cost). For retirement health care benefits, neither the employees nor the employer entity make any contributions while the employee is working.⁷⁵ Therefore, the entire service cost is recognized as a cost to the employer entity and imputed to it.

336. The financing of the imputed cost is also imputed to the employer entity.⁷⁶ The imputed financing is necessary so that the imputed cost

⁷⁴See SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, para. 105-115.

⁷⁵Retired employees do pay premiums, however, and the service cost to the employer entity is defined net of the actuarial present value of those future premiums.

⁷⁶The employer entity’s own contribution, if any, is generally financed by an appropriation but could be financed by earned revenue or other sources.

does not reduce the employer entity's operating results and net position. The imputed financing equals the imputed cost and is recognized as an other financing source. It is not a revenue, because the employer entity does not earn the amount imputed or demand its payment.⁷⁷

337. (This transaction differs from the immediately preceding transaction, in which an entity does not pay the full cost of the goods or services it receives from another entity. In the present case, the employer entity acquires the services of the employees itself, but another entity pays part of their cost.)
338. Contribution by the General Fund to the SMI trust fund.—The General Fund makes a contribution to the SMI (Supplementary Medical Insurance) trust fund. This appropriated payment is separate from the transfer of earmarked premiums and is not a transfer of earmarked taxes or other income. It does not arise from an exchange transaction, because SMI does not sacrifice any value to the General Fund in exchange for the payment, and the General Fund does not receive anything of value from SMI. Instead, the payment constitutes a General Fund subsidy of the SMI trust fund. Since the payment is not demanded or earned, it is an other financing source to SMI rather than a revenue.
339. Examples of other payments of a similar nature (and also classified as other financing sources) are the payment by the General Fund to the social security trust funds for military service credits and for certain uninsured persons at least 72 years old; and the payment by the General Fund to the Railroad Retirement Board for the vested dual benefit payments received by certain retirees under both the railroad retirement and the social security systems. The quinquennial military service credit adjustment paid between the General Fund and the social security trust funds is likewise an other financing source to the social security trust funds but one that may be either positive or negative.

⁷⁷For further discussion of the accounting standards for pensions and other retirement benefits for federal employees, see SFFAS No. 5, Accounting for Liabilities of the Federal Government, para. 56-93 and 148-181. The standards do not cover accounting for the plan *per se* as distinct from the administering entity. Nor do they cover defined contribution plans, or administrative entities that are not Federal reporting entities.

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340. Transfer by CCC to Federal Crop Insurance Corporation.—The Commodity Credit Corporation (CCC) makes transfers to the Federal Crop Insurance Corporation (FCIC), which it finances by an appropriation. This payment does not arise from an exchange transaction, because FCIC does not sacrifice anything of value to CCC, and CCC does not receive anything of value from FCIC. It differs from the contribution to SMI primarily in that it is paid by another program entity (the CCC) rather than directly by the General Fund. Since the payment is not demanded or earned, it is an other financing source to FCIC rather than a revenue.
341. Interchange between the Railroad Retirement Board and the Social Security and Hospital Insurance trust funds.—The Railroad Retirement Board pays benefits equivalent to the amounts that would have been paid if railroad workers had been covered under Social Security since its inception, plus additional amounts unique to that program. The railroad retirement program is partly financed by an annual financial interchange that takes place between the Railroad Social Security Equivalent Benefit Account (a trust fund) and the trust funds for old-age and survivors insurance, disability insurance, and hospital insurance (OASDHI). The interchange is designed to place each of the OASDHI trust funds in the same position as it would have been if railroad employment had been covered under Social Security since its inception.
342. The amount of the payment reflects the difference between (a) the benefits that the OASDHI trust funds would have paid to railroad workers and their families if railroad employment had been covered by OASDHI and (b) the payroll taxes that the OASDHI trust funds would have received if railroad employment had been covered by OASDHI. If benefits would have exceeded taxes, the OASDHI trust funds make a payment to the Railroad Social Security Equivalent Benefit Account; if benefits would have been less, the OASDHI trust funds receive a payment. Currently OASI and DI make payments to that Account, and HI receives payment. The interchange differs from the examples in the previous cases primarily in that (a) the payment is between two trust funds and (b) the payment may be made in either direction.
343. The financial interchange does not arise from an exchange transaction, because it is a reallocation of resources among funds, all of which are financed primarily from nonexchange revenue.

Furthermore, the nature of this reallocation is such that the transferring entity does not receive anything of value and the recipient entity does not sacrifice anything of value. Therefore, the recipient entity recognizes the transfer-in as an other financing source, and the transferring entity recognizes the transfer-out as a negative financing source.

344. Transfer of cash and other capitalized assets without reimbursement.—Cash and other capitalized assets may be transferred without reimbursement from one Government entity to another. Cash may include exchange revenue that is recognized by the transferring entity in determining its net cost of operations but is required to be transferred to the General Fund or another entity; other capitalized assets may include general property, plant, and equipment. The receiving entity does not sacrifice anything of value, and the transferring entity does not acquire anything of value. Therefore, the transfer is not an exchange transaction. The receiving entity recognizes the transfer-in as an other financing source; the transferring entity recognizes the transfer-out as a negative financing source. The amount recorded by both entities is the transferring entity's book value of the asset.
345. Transfer of property, plant, and equipment without reimbursement: types that are expensed.—Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.
346. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

Revaluations

347. Revaluation of capitalized property, plant, and equipment.—Capitalized property, plant, and equipment (PP&E) may be removed from the general PP&E accounts if it no longer provides service in the operations of the entity because it has suffered damage, become obsolete in advance of expectations, or is identified as excess. It is

recorded as an asset at its expected net realizable value. Any difference between the book value and the expected net realizable value is recognized as a gain or loss in determining the net cost of operations, because the revaluation results from the entity's operations. The expected net realizable value is adjusted at the end of each period, and any further revaluation is also recognized as a gain or loss in determining the net cost of operations.⁷⁸

348. Since the revaluation does not affect obligations incurred but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.
349. Revaluation of inventory and related property.—Inventory and related property may be revalued for such reasons as determination that the property is excess, obsolete, or unserviceable; that stockpile materials have decayed or been damaged; that a loss is estimated on commodity purchase agreements; or that a change has occurred in the net realizable value of commodities valued at the lower of cost or net realizable value. The amount of revaluation is recognized as a loss or a gain in determining the net cost of operations, because it results from the entity's operations. Assets are correspondingly reduced or increased.⁷⁹
350. Since the revaluation does not affect obligations incurred, but does affect net cost, an amount equal to the revaluation is recognized in determining the reconciliation between obligations incurred and net cost of operations. A reconciliation is not needed in determining the change in net position, because the revaluation affects net cost and net position equally.

⁷⁸SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 39.

⁷⁹See SFFAS No. 3, Accounting for Inventory and Related Property, para. 29-30, 47-48, 54, 97, and 107.

Transactions Not
Recognized As
Revenues, Gains, Or
Other Financing Sources

351. Borrowing from the public.—Borrowing from the public is a means of financing the Government's outlays. However, it is not a net inflow of resources to the Treasury or other borrowing entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.
352. Borrowing from Treasury, the Federal Financing Bank, or other Government accounts.— An entity may be provided the authority to borrow from Treasury, the Federal Financing Bank, or other Government accounts. Intragovernmental borrowing is a means of financing the entity's outlays. However, it is not a net inflow of resources to the entity, because the asset received (cash) is offset by an equal liability (debt). Therefore, it is not revenue or an other financing source.
353. Disposition of revenue to other entities: custodial transfers.— Revenue, primarily nonexchange revenue, may be collected by an entity acting on behalf of the General Fund or another entity within the Government on whose behalf it was collected. The collecting entity accounts for the disposition of revenue as part of its custodial activity. These custodial transfers, by definition, do not affect the collecting entity's net cost of operations or operating results, nor are they part of the reconciliation between its obligations and net cost of operations. (The receiving entity recognizes the revenue as nonexchange or exchange revenue, depending on its nature, according to the applicable revenue standards.)
354. Sales of different types of Government assets.—The sale of Government assets (other than forfeited property) is an exchange transaction, because each party receives and sacrifices something of value. As a general rule, any difference between the sales proceeds and book value is recognized as a gain or loss when the asset is sold. The remainder of the transaction does not provide a net inflow of resources, so no gain, revenue, or other financing source is recognized. If the sales proceeds equal book value, there is no gain or loss, because the exchange of one asset for another of equal recorded value is not a net inflow of resources.
355. This general rule applies to property, plant, and equipment, receivables (other than direct loans), foreclosed property associated with pre-1992 direct loans and loan guarantees, and miscellaneous assets. It does not apply to inventory, nor does it apply to forfeited property (as explained

in the previous section on nonexchange revenue). It also does not apply to the sale of direct loans and the sale of foreclosed property associated with post-1991 direct loans and loan guarantees. The latter transactions are discussed in subsequent paragraphs.

356. Acquisition of property, plant, and equipment through exchange.—The cost of property, plant, and equipment (PP&E) acquired through an exchange of assets with the public is the fair value of the PP&E surrendered at the time of exchange. If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost is the fair value of the PP&E acquired. If neither fair value is determinable, the cost of the PP&E acquired is the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. In the event that cash consideration is included in the exchange, the cost of PP&E acquired is increased (or decreased) by the amount of the cash surrendered (or received).⁸⁰
357. Any difference between the cost of the PP&E acquired and the book value of the PP&E surrendered is recognized as a gain or loss. If the cost of the PP&E acquired equals the book value of the PP&E surrendered, there is no gain or loss (nor a revenue or other financing source), because the exchange of one asset for another of equal value does not provide a net inflow of resources. Therefore, the amount of the transaction equal to the book value of the PP&E surrendered is not recognized as a gain, a revenue, or an other financing source.
358. Transfer of property, plant, and equipment without reimbursement: types that are expensed.—Property, plant, and equipment (PP&E) of types that are expensed (i.e., stewardship PP&E) may be transferred from one Government entity to another. If the asset was classified as stewardship PP&E in its entirety by both the transferring entity and the recipient entity, the transfer does not affect the net cost of operations or net position of either entity and therefore in such a case it is not a revenue, a gain or loss, or other financing source.
359. However, if the asset that is transferred was classified as general PP&E for the transferring entity but stewardship PP&E for the recipient entity, it is recognized as a transfer-out (a negative other financing source) of capitalized assets by the transferring entity.

⁸⁰See SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 32.

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360. If multi-use heritage assets are transferred and some cost was recognized for them on the books of the transferring entity, that cost is recognized as a transfer-out (a negative other financing source) of capitalized assets. No amount is recognized by the entity that receives the asset.⁸¹
361. Donation of property, plant, and equipment: types that are expensed.—The acquisition cost of stewardship property, plant, and equipment (PP&E) is recognized as a cost when incurred. Such PP&E consists of Federal mission PP&E, heritage assets, and stewardship land. When such PP&E is donated to the Government, however, no amount is recognized as a cost.⁸² Since the donation of such PP&E does not affect the net cost or net position of the recipient entity, it is not a revenue, a gain, or an other financing source.
362. Negative subsidies on post-1991 direct loans and loan guarantees.—A negative subsidy means that the direct loans or loan guarantees are estimated to make a profit, apart from administrative costs (which are excluded from the subsidy calculation by law). The amount of the subsidy cost is recognized as an expense when the direct loan or guaranteed loan is disbursed. A negative subsidy is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.⁸³
363. Downward subsidy reestimates for post-1991 direct loans and loan guarantees.—A downward subsidy reestimate means that the subsidy cost of direct loans or loan guarantees is estimated to be less than had previously been estimated. The initial subsidy cost is recognized as an expense; a positive subsidy reestimate is recognized as an expense; and a downward subsidy reestimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source.
364. Fees on post-1991 direct loans and loan guarantees.—The present value of estimated fees is included as an offset in calculating the

⁸¹SFFAS No. 6, Accounting for Property, Plant, and Equipment, para. 61 and 72.

⁸²Ibid.

⁸³For standards on direct loans and loan guarantees, see SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees. The accounting for negative subsidy costs is symmetrical to the accounting for positive subsidy costs.

subsidy cost of direct loans and loan guarantees, which is recognized as an expense when the loans are disbursed. The present value of estimated fees is likewise included as one component in calculating the value of loans receivable or loan guarantee liabilities. When cash is received in payment of fees, the loans receivable decrease by an equal amount (or the loan guarantee liabilities increase by an equal amount). The increase in one asset is offset by an equal decrease in another asset (or by an equal increase in liabilities). Therefore, fees are not recognized as a revenue, a gain, or an other financing source.⁸⁴

365. Repayment of post-1991 direct loans.—The present value of estimated loan repayments is included in the calculation of the subsidy cost of direct loans, and this subsidy cost is recognized as an expense when the loans are disbursed. The present value of estimated loan repayments is likewise included in the value of the loans receivable. When cash is received for the repayment of loans, the loans receivable decrease by an equal amount. The increase in one asset is offset by an equal decrease in another asset. Therefore, cash inflow from the repayment is not recognized as a revenue, a gain, or an other financing source.⁸⁵
366. Repayment of pre-1992 direct loans.—When pre-1992 direct loans are repaid in whole or in part, the entity exchanges one asset (loans receivable) for another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.⁸⁶
367. Repayment of receivables: except direct loans.—When receivables other than direct loans are paid or repaid in whole or in part, the entity exchanges one asset (loans receivable) for another (cash) with equal value. There is no net inflow of resources. Therefore, the amount of

⁸⁴The fee component of the subsidy cost is required to be disclosed separately.

⁸⁵If the actual repayment is different from the previous estimate, the present value of the difference between cash inflows and outflows over the term of the loan—calculated as of the date of disbursement—is reestimated and is recognized as a subsidy expense or a reduction in subsidy expense.

⁸⁶If the loan is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.⁸⁷

368. Sales of direct loans.—The sale of a direct loan is a modification according to the Federal Credit Reform Act of 1990 regardless of whether the loan being sold was obligated after FY 1991 or before FY 1992. The book value loss (or gain) on a sale of direct loans equals the book value of the loans sold (prior to sale) minus the net proceeds of the sale. It normally differs from the cost of modification, which is recognized as an expense.⁸⁸ Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.⁸⁹ The amount of cash inflow equal to book value is not a net inflow of resources to the entity, because it is an exchange of one asset for another of equal recorded value. Therefore, the amount of cash inflow equal to book value is not recognized as a revenue, a gain, or an other financing source.
369. Sales of foreclosed property: associated with post-1991 direct loans and loan guarantees.—The net present value of the cash flow from the estimated sales of foreclosed property is included in calculating the subsidy cost of post-1991 direct loans and loan guarantees. This subsidy cost is recognized as an expense when the loans are disbursed. When property is foreclosed, the property is recognized as an asset at the net present value of its estimated net cash flows. When the foreclosed property is sold, any difference between the sales proceeds and the book value (i.e., the net present value as of the time of sale) requires a reestimate of the subsidy expense, which is recognized as a subsidy expense or a reduction in subsidy expense. The amount of cash flow equal to book value is an exchange of one

⁸⁷If the receivable is not repaid, the unpaid amount is recognized as an adjustment to the bad debt allowance and does not affect revenue, gains, or other financing sources.

⁸⁸This difference is due to the different interest rates used to discount future cash flows for calculating the subsidy cost (and subsidy allowance) when the loan is disbursed and for calculating the cost of modification at a later time. If the sale is with recourse, the present value of the estimated loss from the recourse is also recognized as an expense.

⁸⁹SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, para. 53-55 and Appendix B, Part II(B).

asset for another of equal recorded value and therefore is not recognized as a gain, a revenue, or an other financing source.⁹⁰

370. Deposit fund transactions.—Deposit funds are accounts outside the budget that record amounts that the Government (a) holds temporarily until ownership is determined or (b) holds as an agent for others. The standards and guidance in this Statement do not apply to deposit funds except insofar as a particular deposit fund may be classified as part of a Federal reporting entity or a disclosure may be required due to a fiduciary relationship on the part of a Federal reporting entity toward a deposit fund.

⁹⁰See SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, para. 57-60 and Appendix B, Part III(E); and SFFAS No. 3, Accounting for Inventory and Related Property, para. 79-91 and 154-158.

Appendix C: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

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**List of
Abbreviations**

See Consolidated List of Acronyms in “Appendix F: Consolidated List of Abbreviations” on page 1425.

Statement of Federal Financial Accounting Standards 8: Supplementary Stewardship Reporting

Status

Issued	June 11, 1996
Effective Date	For fiscal years beginning after September 30, 1997 except for the consolidated financial report of the Federal Government (CFR). For the CFR: Chapters 2 through 7 are not effective until further action by the Board and its principals; Chapter 8, Current Services Assessments, is effective for fiscal years beginning after September 30, 1997.
Volume II References	Heritage Assets (H20), Human Capital (H60), Nonfederal Physical Property (N60), Research and Development (R20), Stewardship Land (S60), Stewardship Reporting (S70)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 17 provides standards for accounting for social insurance. SFFAS 8, paragraphs 116-117 deferred consideration of social insurance.• SFFAS 23, par. 9 affects SFFAS 8 by rescinding the prefatory box preceding paragraph 52 and paragraphs 52 through 70 (Chapter 3).• SFFAS 25, paragraph 5 rescinds chapter 8 and paragraphs 14-16 of SFFAS 8, and the associated Illustration of the Current Services Assessment in Appendix B of SFFAS 8.• SFFAS 29, par 12 rescinded Chapter 2 (Heritage Assets) and par. 31 rescinded Chapter 4 (Stewardship Land) and the associated Illustrations in Appendix B of SFFAS 8. SFFAS 29 provides the standards for Heritage Assets and Stewardship Land.

Summary

This Statement establishes standards for reporting on the Federal Government's stewardship over 1) certain resources entrusted to it, identified as stewardship property, plant, and equipment and stewardship investments, and 2) certain responsibilities assumed by it, identified as the current service assessment. The resources and responsibilities do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but are, nonetheless, important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they should be recognized in the financial reports of the Federal Government and of its component entities.

Stewardship resources are investments by the Federal Government for the benefit of the Nation. When made, they are treated as expenses in the financial statements. These expenses, however, are intended to provide long-term benefits to the public. Therefore, this Statement requires that information on these resources be reported to highlight their long-term-benefit nature and to demonstrate accountability over them. Depending on the nature of the resources, stewardship reporting could consist of financial and nonfinancial data.

This Statement establishes reporting requirements based on the categories defined below:

- a The purpose of this Statement is to establish standards for reporting on the Federal Government's stewardship over 1) certain resources entrusted to it, identified as stewardship property, plant, and equipment and stewardship investments, and 2) certain responsibilities assumed by it, identified as the current service assessment. The resources and responsibilities do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but are, nonetheless, important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Because the Government has been entrusted with, and made accountable for, these resources and responsibilities, they should be recognized in the financial reports of the Federal Government and of its component entities. This determination was made to more fully satisfy the stewardship objective defined in the concepts statement, Objectives of Federal Financial Reporting.¹
- b The stewardship objective requires that the Federal Government "report on the broad outcomes of its actions." Such reporting will provide information that could help report users assess the impact of the Government's operations and activities for the period on its financial condition.²
- c Stewardship resources involve substantial investment by the Federal Government for the benefit of the Nation. When made, they are treated as expenses in the financial statements. These expenses, however,

¹ *Objectives of Federal Financial Reporting*, SFFAC No. 1, September 1993.

² *Ibid.*, pp. 41-42.

are intended to provide long-term benefits to the public. Therefore, this Statement requires that information on these resources be reported to highlight their long-term-benefit nature and to demonstrate accountability over them. Depending on the nature of the resources, stewardship reporting could consist of financial and nonfinancial data.

- e Given the above purpose, this Statement established standards for supplementary stewardship reporting for Stewardship Investment

- g Stewardship Investments - items treated as expenses in calculating net cost but meriting special treatment to highlight their substantial investment and long-term-benefit nature. This includes:
 - Nonfederal Physical Property - grants provided for properties financed by the Federal Government, but owned by the state and local governments.

 - Costs incurred for education and training programs that are designed to increase or maintain national economic productive capacity and research efforts to provide future benefits or returns. These include:
 - Human Capital - education and training programs financed by the Federal Government for the benefit of the public.

 - Research and Development - basic and applied research and development.

- j All stewardship information is deemed "required supplemental stewardship information" (RSSI). Audit requirements for RSSI will be established in a collaborative effort by the Office of Management and Budget (OMB) and the Government Accountability Office (GAO).

- k The introduction and background chapter of this standard provides information on the approaches used to develop the standards for supplementary stewardship reporting. Appendices include a basis for the Board's conclusions, sample stewardship reports, and a glossary of terms used in the Statement. First-time use of glossary terms within the body of this document appear in boldface.

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Chapter 1: Introduction And Background

Purpose

1. The purpose of this Statement is to establish standards for reporting on the Federal Government's **stewardship** over certain resources entrusted to it, and certain responsibilities assumed by it. The resources and responsibilities relate to those which do not meet the criteria for assets and liabilities that are required to be reported in the financial statements but that are important to an understanding of the operations and financial condition of the Federal Government at the date of the financial statements and in subsequent periods. Costs of these stewardship-type resources are treated as **expenses** in the financial statements in the year the costs are incurred. However, these costs and resultant resources are intended to provide long-term benefits to the public and are included in stewardship reporting to highlight for the reader their long-term-benefit nature and to demonstrate accountability over them.
2. Specific descriptions of these stewardship-type resources are addressed later in this chapter and in the individual standards (chapters 2-7) in this Statement. Generally, stewardship reporting on these resources includes:
 - Information on investment in physical capital other than that used to support Federal operations to provide goods and services to the public, that is, investment in other than general property, plant, and equipment (PP&E).³
 - Information on investment in other than physical capital. Such information, as well as the information called for in the paragraph above, will be reported for stewardship purposes on an investment basis (that is, as benefitting more than the current reporting period) rather than a consumption basis (that is, benefitting only the current reporting period). Such a

³Physical assets supporting Federal operations to provide goods and services to the public, referred to as general property, plant and equipment (PP&E), are addressed in *Accounting for Property, Plant and Equipment*, SFFAS No. 6.

presentation could help users analyze all Federal investment on an equal basis, and make decisions among competing investments, such as when allocating Federal resources or deciding whether to authorize new programs or modify ongoing programs.

- Information that could assist in measuring the success of certain programs. The measurement of the benefits received for the dollars invested and the evaluation of program performance could appear with other stewardship information as part of the financial statements, or in other financial reports, for example, in a report on program performance.
3. This Statement also established standards for providing information on stewardship responsibilities (chapter 8) through projections for the Government as a whole. The projections will aid in assessing the Government's financial condition and the sufficiency of future budgetary resources to sustain public services and meet obligations as they come due.
 4. Each standard is summarized briefly in a box followed by a detailed explanation of the standard. However, the standards comprise the summaries in the boxes and the entire text of the explanations.

Background And Rationale

5. The Concepts Statement, *Objectives of Federal Financial Reporting* was developed on the basis of an in-depth assessment of user needs and is used to guide the Board in developing Federal accounting and reporting standards. The objectives cover four areas: budgetary integrity, operating performance, stewardship, and systems and control.
6. This Statement of accounting standards addresses the objective of reporting on stewardship over certain resources entrusted to the Federal Government and responsibilities assumed by it. The need for a report on the Federal Government's stewardship over the resources entrusted to it and the responsibilities it has assumed, arises because of the unique nature of the Federal Government, as described in the following section.

Stewardship And The Reporting Objectives

7. “Financial position” is a representation of an entity’s economic resources and the claims on those resources as of a particular date. In the private sector, the principal objective of reporting on financial position is to assess the viability of the entity, the business firm, and its potential profitability.
8. Assessing the overall performance of the Federal Government is not exclusively a matter of comparing revenue and expense, or its accumulated assets and liabilities.
9. The Federal Government’s viability and perpetuity are assumed. It has unique access to financial resources and financing, and the power to tax, to borrow, and to create money. For the Federal Government, financial performance is a vital issue, but traditional financial measures provide data that are appropriate for assessing only some, not all, of the responsibilities for which the Government should be held accountable. Since it exists not to make a profit but to serve the needs of the citizens and to promote the general welfare of the Nation, other measures of accountability need to be used. Measures of accountability are to be reported for elements that are defined as stewardship property, plant, and equipment (PP&E); stewardship investments; and stewardship responsibilities. These elements of stewardship exist because the Federal Government is dissimilar to industrial and commercial entities.

Financial Condition

10. The measures of accountability mentioned above help to portray the Government’s “financial condition.” Financial condition is a broader and more forward-looking concept than is financial position. Financial condition allows an assessment of an entity on the basis of additional data that could include financial and nonfinancial information about current conditions. These additional data provide a more complete indication of performance. In some cases, it may be necessary to present and characterize financial data in ways that differ from traditional financial reporting and to supplement traditional data with nonfinancial data. In other cases, it may be necessary to rely almost entirely on nonfinancial data to provide a more complete presentation of entity performance. Moreover, assessment of financial condition

could include analysis of trends, demands, commitments, events, and uncertainties.⁴

Stewardship PP&E

11. “Stewardship PP&E” consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differ from general PP&E in that their values may be indeterminable or may have little meaning (for example, museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (for example, military weapons systems and space exploration hardware) to accounting periods that benefit from the ownership of such assets is meaningless. However, the Federal Government should be able to demonstrate accountability for stewardship PP&E by reporting on its existence and on its condition by a reference to deferred maintenance reported in the financial statements. Stewardship PP&E would include stewardship land (that is, land not acquired for or in connection with general property, plant, and equipment); heritage assets (for example, Federal monuments and memorials and historically or culturally significant property); and ... [National Defense] property, plant, and equipment (for example, ... military weapons systems).

Stewardship Investments

12. “Stewardship investments” are substantial investments made by the Federal Government for the benefit of the nation. When incurred, they are treated as expenses in determining the net costs of operations. However, these items merit special treatment so that readers of Government financial reports know the extent of these investments that are made for long-term benefit. Such investments will be measured in terms of expenses incurred for certain education and training programs; federally financed research and development; and federally financed but not federally owned property, such as bridges and roads.
13. Because the Government has been entrusted with and made accountable for these resources, they should be reported in the financial reports of the Government and of its component entities. This will help satisfy the stewardship objective defined in the concepts statement, *Objectives of Federal Financial Reporting*, SFFAC No. 1.

⁴Chapter 7 of the *Objectives of Federal Financial Reporting* provides a full discussion of financial position and financial condition.

The goal of the stewardship objective is that the Federal Government “report on the broad outcomes of its actions.” Such reporting may provide information that could help report users assess the impact of the Government’s operations and investments for the period.⁵

- Stewardship Responsibilities
14. A key aspect of the stewardship objective requires that Federal reporting provide information that helps users determine (1) whether the Government’s financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.⁶
 15. Information on “stewardship responsibilities” will aid in these determinations. It will provide an essential perspective on the Government’s commitment to discretionary and mandatory programs.
 16. Reporting on this stewardship responsibility may be accomplished in a stewardship section in the consolidated financial report of the Federal Government.

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- Stewardship Categories Or Elements
17. In defining the specific categories of items, or elements, that would appear as stewardship information, the Board decided on the following:
 - Property owned by the Federal Government and meeting the definition of one of the following three categories:
 - Property, plant, and equipment of historical, natural, cultural, educational or artistic significance, referred to as heritage assets, for example, the Washington Monument and the Lincoln Memorial; ...⁷
 - ... [See SFFAS 14 for the explanation of deletion and change to “National defense PP&E”] and

⁵See SFFAC No. 1, pp. 41-42.

⁶Ibid., pp. 42-44.

⁷... [see SFFAS No. 14]

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- Investments in stewardship land,⁸ that is, land not acquired for or in connection with general property, plant, and equipment, for example, national forests, parks, and historic sites. Some investments in stewardship land, for example national parks, will be reported by both 1) the number of acres used as a park or an historic site in the stewardship land category, and 2) by the number of physical units identified as national parks in the heritage assets category. Such reporting would not be considered duplication, as the type of information reported on an item would be different for each category of stewardship asset.
 - Properties financed by the Federal Government but owned by state and local governments, referred to as nonfederal physical property, for example, highways and bridges.
 - Expenses that are incurred for education and training that are intended to increase national economic productive capacity or for research and development that are intended to provide future benefits or returns. This includes:
 - Investments in human capital, that is, education and training programs provided by the Federal Government, for example, job training programs, and grants for higher education.
 - Investments in research and development, for example, research on the effects of early medical intervention in delaying the onset of AIDs symptoms in HIV-positive individuals, and Federal investment in genetic code research to advance national medical research.
 - Information on the projected financial impact on the Government of providing current services, assuming a continuation of current programs. This information will be in the form of a current services assessment providing future receipt and outlay data on the basis of projections of future activities for the Government as a whole and will include both discretionary and mandatory programs and interest on debt.

⁸The Board is including only surface land as supplementary stewardship information because the issues associated with other than surface land, i.e., the natural resources on and under that land, are complex. The Board is researching these complex issues and will publish a separate exposure draft on a proposed accounting standard for natural resources at a later date.

The Nature of Stewardship Reporting	18. The previous categories of items or elements result from or exist largely because of the Federal Government's role as a sovereign power. The components that they include are defined and discussed in detail in their respective chapters of this standard.
	19. The Board, recognizing the Federal Government's size, complexity, diversity, and impact on others, has determined that the aforementioned information is needed in addition to that included in financial statements.
	20. Such information may not link directly with the basic financial statements because the data to be reported may be other than financial, for example, physical units or projections. It will supplement the basic financial statements.
21. This information, as indicated in each of the standards, will be designated as required supplementary stewardship information (RSSI) for the consolidated financial statements of the Federal Government and of the entities who have stewardship responsibilities over resources identified earlier in this document. The Board has chosen to call this RSSI to distinguish it from "required supplementary information" (RSI), for which audit responsibilities are prescribed in existing professional literature. The Board believes that OMB and GAO should establish and cause the implementation of the audit responsibilities for RSSI.	
Stewardship Information	22. Stewardship information may be presented in varying formats depending on the nature of the Federal investments or claims to Federal resources controlled by an entity. Such information is required for those entities (1) that control stewardship resources and (2) whose financial statements purport to be in accordance with Federal accounting principles as recommended by FASAB, and approved by the Secretary of the Treasury, the Director of OMB and the Comptroller General.
	23. Examples of selected portions of stewardship report sections are included at Appendix B.
Measurement	24. The separate standards for each stewardship element contain specific guidance for that element. In general, however, stewardship

investments shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and a share of the cost of facilities (for example, depreciation).⁹

25. For investments that are intended to maintain or increase the economic productive capacity of the Nation, that is, investments in human capital, research and development, and nonfederal physical property, trend data shall be presented. Trend data should reflect the full cost (including allocation of facility and administrative costs) of the investment.
26. For stewardship land and heritage assets, measurement will be done on other than a financial basis. For example, measurement may be on the basis of physical units, such as acres of land. Specific data requirements are addressed in the individual stewardship standards.
27. Generally, amounts shall be reported in nominal dollars. If trend data that span many years are reported and the entity believes that constant dollar information would be meaningful for data interpretation, constant dollar data may be provided in addition to nominal dollar data.
28. **Split Grants.** Frequently, stewardship elements are financed by grants. In some cases, the grants may have more than one purpose.¹⁰ For such grants, the investment shall be allocated among stewardship elements on the basis of an estimate of the proportionate funding of the various grant objectives. If allocation is not feasible, the investment shall be reported on the basis of the predominant use of the grant.
29. **Performance Indicators.** For some stewardship elements, categorization of these elements as investments is predicated on producing outputs and outcomes. The specific procedures, including a phasing-in process for requiring such justification, is contained in the individual respective standards.

⁹See *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4, for a discussion of Federal cost accounting principles and standards.

¹⁰An example of a grant with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.

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30. **Reporting Program Expenses.** Trend data reported on stewardship investment elements should reflect the full cost¹¹ of the investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would better indicate the investment nature of an item.
31. In some cases, before the issuance of Federal accounting standards, entities have maintained records on the basis of outlays rather than expenses. It may be impracticable for such entities to reconstruct their accounts on the basis of expense. In such cases, entities may report data on an outlay basis for any years for which expense data are not available. At the end of 5 years, entities should have sufficient expense data to be able to report expenses rather than outlays.
32. **Reporting Deferred Maintenance.** Many state and local governments, members of Congressional oversight committees, and national groups, have raised the issue of the deteriorating condition of federally-owned PP&E because of deferred maintenance associated with these assets. The issue was addressed in association with PP&E. As a result, a deferred maintenance standard in *Accounting for Property, Plant, and Equipment*, SFFAS No. 6, establishes reporting requirements related to the condition and future maintenance requirements for PP&E.
33. These requirements are flexible since different conditions may be considered acceptable by different entities, as well as for different items of PP&E held by the same entity. The deferred maintenance standard is applicable to all PP&E whether the PP&E is reported as general PP&E or stewardship PP&E.

Reporting Requirements

34. Within each of the standards, minimum required and, in some cases, recommended reporting is described. These requirements and recommendations, including a phasing-in process for entities who may not have required data available at the implementation of the standards, are contained in the individual standards. These requirements describe the nature of items to be reported by Federal entities; guidance on the form and content of agency financial reports,

¹¹See *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4, for a discussion of Federal cost accounting principles and standards.

including the specific guidance on the format in which items addressed in this Statement will be reported, will be prescribed by OMB.

35. Reporting should be at the major program or category level; individual transactions need not be reported unless significant. Additional reporting is encouraged when preparers believe such information would make the financial report more meaningful or understandable.

Social Insurance

36. The Board first considered accounting and reporting for social insurance programs while considering SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The Board concluded, at that time, that the topic should be made part of the Supplementary Stewardship Reporting project.
37. Research and deliberations regarding social insurance have continued as part of the Supplementary Stewardship Reporting project. However, the Board, recognizing the magnitude and complexity of these programs, the strength of the views on the accounting and reporting issues, the significant attention being focused on these programs at the present time, and the potential for change to the programs, has again concluded that additional consideration is appropriate before issuing final guidance. Accordingly, the Board has not included guidance on social insurance in this Statement and has added a Social Insurance Accounting project to its agenda.

Applicability

38. This standard requires that the consolidated financial reports¹² of the Federal Government and the financial reports of its component units contain RSSI relating to:

¹²The terms “financial statements” and “consolidated financial statements” are used throughout this document to refer to the basic financial statements of a reporting entity; the basic financial statements normally include: the balance sheet, the statements of net cost, changes in financial position, financing, budgetary resources, and custodial activities and the notes to the financial statements. The terms “financial reports” and “consolidated financial reports” are used to refer to a document which would include the financial statements but which would also include items such as: a management discussion and analysis section, a statement of program performance measures, required supplemental information or required supplementary stewardship information not included in the financial statements or other supplemental financial and management information.

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- amounts invested in human capital, research and development, and nonfederal physical property; and
 - quantities (stated in terms of physical units or dollars) of land, heritage assets, ... [See SFFAS 11 for the explanation of deletion and change to “National Defense”] property.

Although FASAB’s sponsors do not set accounting standards for the legislative or judicial branches, Federal accounting standards would be appropriate for them.

39. Because the financial reports of the Federal Government present the aggregation of information about stewardship investments and assets related to varied agencies and programs, further deliberations by the Board are needed to reach a decision on the amount and nature of information to be required under this standard for reporting in the consolidated financial report. Accordingly, except for the standard described in Chapter 8, “Current Service Assessment,” the effective date of the stewardship standards as they apply to the consolidated financial report, is deferred pending that decision. The effective date of the standard in Chapter 8 is for fiscal periods beginning after September 30, 1997. In the interim, the consolidated financial reports should include such summary or selected information as is feasible. Experimentation is encouraged, as is the reporting of such additional information as will enhance the financial report.
40. Some Federal entities, including those government corporations listed in the Government Corporation Control Act and certain others, such as the US Postal Service, are required by law or policy to publish financial statements pursuant to the standards issued by the Financial Accounting Standards Board (FASB). (Some entities also may be required to prepare statements pursuant to standards set by a regulatory agency. That practice would not be affected by this statement of standards.) For such entities, this standard provides the following general principles:
 - *Applying Applicable Accounting Principles* - Separately issued (stand-alone) general-purpose financial statements on such entities should apply applicable accounting principles that will best meet user needs and comply with any relevant statutory requirements. This principle would continue to be true for separately issued statements even if, pursuant to the provisions below, other information about these entities might need to be

presented when their financial statements are included within reports of a larger Federal entity.

- *Reporting Additional or Supplementary Information* - When financial information on such entities is included in general-purpose financial reports of a larger Federal reporting entity (including Treasury's consolidated financial report), any applicable standards recommended by the FASAB and issued by OMB and the Government Accountability Office (GAO) that call for additional reporting or supplementary information should be applied.
- *Applying Applicable Standards When Differences Arise* - When financial information on such entities is included in general purpose financial reports of a larger Federal reporting entity (including Treasury's consolidated financial report), standards recommended by FASAB and issued by OMB and GAO should be used if the difference arising from differences between Federal accounting standards and FASB's would be material to users of the report of the larger entity.

Materiality

41. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

42. The accounting standards in this statement, except for the standards described in Chapters 2-7 to the extent that they related to the consolidated financial report of the Federal Government, are effective for fiscal periods beginning after September 30, 1997. Earlier implementation is encouraged. See paragraph 39 for the effective date of standards in Chapters 2-7 relating to the consolidated financial report.

...[Chapter 2 was rescinded by SFFAS 29, par. 12. See SFFAS 29 for Standards on Heritage Assets.]

...[Chapter 3 (par. 52-70) was rescinded by SFFAS 23, par. 9.]

...[Chapter 4 was rescinded by SFFAS 29, par. 31. See SFFAS 29 for Standards on Stewardship Land.]

Chapter 5: Nonfederal Physical Property Standard

Nonfederal Physical Property

Expenses included in calculating net cost for nonfederal physical property programs shall be reported as investments in required supplementary stewardship information accompanying the financial statements of the Federal Government and the separate reports of component units of the Federal Government responsible for such investments. Reporting will include data, in nominal dollars, on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the nature of the investment.

Definition

83. "Investment in nonfederal physical property" refers to those expenses incurred by the Federal Government for the purchase, the construction, or the major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements; the purchase of major equipment; and the purchase or improvement of other physical assets. Grants for maintenance and operations are not considered investments.

Measurement

84. "Expenses incurred" - The financial investment shall be measured on the same basis of accounting as used for financial statement purposes, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.²⁸ Amounts shall be reported in nominal dollars.
85. Cash grants related to nonfederal physical property programs are recognized and reported as expenses in arriving at the net cost of operations.

²⁸See *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.

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86. Expenses incurred for program costs, contracts, or grants with split purposes²⁹ shall be reported on the basis of an allocation of the expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expense or transfer.

Minimum Reporting

87. Minimum reporting shall include the following:
- Annual investment³⁰ shall be reported, including a description of Federally-owned physical property transferred to state and local governments. This information will be provided for the year ended on the balance sheet date as well as for each of the 4 years preceding that year. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported.
 - Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major investments at the entity level shall be more specific than at the governmentwide level.
 - In some cases, the information called for above is not available because entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report only expense data for the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be categorized as investments for nonfederal physical property rather than the outlays for each of the preceding 5 years.

²⁹An example of an investment with a split purpose is a grant issued to a state to construct segments of the National Highway System and to conduct highway research.

³⁰As defined in this standard, "annual investment" includes more than the annual expenditure reported by character class for budget execution. "Annual investment" is the full cost of the investment. Full cost shall be measured and accounted for in accordance with *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4.

- Reporting shall include a description of major programs involving Federal investments in nonfederal physical property including a description of programs or policies under which non-cash assets are transferred to state and local governments.

Recommended Reporting

88. Reporting of the amount of significant state and local total contributions to shared or joint programs is encouraged but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the total program) shall be reported even if the exact amount of the contribution is not known.

Chapter 6: Human Capital

Human Capital

Expenses included in calculating net cost for education and training programs that are intended to increase or maintain national economic productive capacity shall be reported as investments in human capital as required supplementary stewardship information accompanying the financial statements of the Federal Government and its component units. Continued categorization of expenses as investments for stewardship purposes is predicated on demonstrated outputs and outcomes consistent with the intent of the program. Reporting will ordinarily include data in nominal dollars on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the investment.

Definition

89. "Investment in human capital" refers to those expenses incurred for programs for education and training of the public that are intended to maintain or increase national productive capacity and that produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity.
90. The definition excludes education and training expenses for Federal civilian and military personnel. It also excludes education and training expenses whose purpose is not maintaining or enhancing national productive capacity.

Measurement

91. “Expenses incurred” - The investment shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.³¹ Amounts shall be reported in nominal dollars.
92. Expenses incurred for programs, contracts, or grants with split purposes³² shall be reported on the basis of an allocation of the investment expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expenses incurred.
93. By no later than the third year after the effective date of this standard, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported. If outcome data are not available (for example, the agency has not agreed on outcome measures for the program, the agency is unable to collect reliable outcome data or the outcomes will not occur for several years), output data that best provide indications of the intended program outcomes shall be used to justify continued treatment of expenses as investments until outcome data are available. Definitions and characteristics of outputs and outcomes are provided in the paragraphs that follow.³³
- “Output” - A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. Outputs shall have two key characteristics: (1) they shall be systematically or periodically captured through an accounting or management information system, and (2) there shall be a logical connection between the reported measures and the program’s purpose. Examples of human capital output are high

³¹See *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.

³²An example of an investment with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.

³³The human capital outputs and outcomes should be the same as those measured for the Government Performance and Results Act (GPRA) and the budget and could be reported in a Statement of Program Performance Measures as described in Appendix 1-F to the concepts statement entitled, *Entity and Display*, SFFAC No. 2.

school and college graduates as a percentage of population over 25.

- “Outcome” - An assessment of the results of a program compared to its intended purpose. Outcomes shall: (1) be capable of being described in financial, economic, or quantitative terms and (2) provide a plausible basis for concluding that the program has had or will have its intended effect. Examples of human capital outcomes are program graduates obtaining jobs within 2 months of program completion or program graduates obtaining jobs making more money than they previously received on Federal aid.

Minimum Reporting

94. Minimum reporting shall consist of:

- The annual investment³⁴ made in the year ended on the balance sheet date as well as in each of the 4 years preceding that year shall be reported. If data for additional years would provide a better indication of investment, reporting of the additional years’ data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported. Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major efforts at the entity level shall be more specific than at the governmentwide level.
- In some cases, the information called for above will not be available because entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report expense data for only the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be

³⁴As defined in this standard, “annual investment” includes more than the annual expenditure reported by character class for budget execution. “Annual investment” is the full cost of the investment. Full cost shall be measured and accounted for in accordance with *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4.

categorized as investments for human capital rather than the outlays for each of the preceding 5 years.

- A narrative description of major education and training programs considered Federal investments in human capital shall be included.

Recommended Reporting

95. Reporting of the amount of significant state, local, private, or foreign total contributions to shared or joint programs is encouraged, but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the total program) may be reported even if the exact amount of the contribution is not known.

Chapter 7: Research & Development

Research and Development

Expenses included in calculating net cost for research and development programs that are intended to increase or maintain national economic productive capacity or yield other future benefits shall be reported as investments in research and development in required supplementary stewardship information accompanying the financial statements of the Federal Government and its component units. Continued categorization of program expenses as investment is predicated on output and outcome data consistent with the program's intent. Reporting ordinarily will include data in nominal dollars on investment for the year being reported upon and the preceding 4 years. Additional years' data also may be reported if such data would provide a better indication of the investment.

Definition

96. "Investment in research and development" refers to those expenses incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of
- Basic research: systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of

observable facts without specific applications toward processes or products in mind;

- Applied research: systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met; and
- Development: systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.³⁵

Measurement

97. “Expenses incurred” - The investment shall be measured on the same basis of accounting as used for financial statements, including appropriate accrual adjustments, general and administrative overhead, and costs of facilities.³⁶ Amounts shall be reported in nominal dollars.
98. Expenses incurred for programs, contracts, or grants with split purposes³⁷ shall be reported on the basis of an allocation of the investment expenses. If allocation is not feasible, the investment shall be reported on the basis of the predominant application of the expenses incurred.
99. By no later than the third year after the effective date of this standard, managers of the investment program should be able to provide information on the outcomes for the programs for which the investments are reported.³⁸ If outcome data are not available (for example, the agency has not agreed on outcome measures for the program, the agency is unable to collect reliable outcome data, or the outcomes will not occur for several years), the outputs that best provide indications of the intended program outcomes shall be used to

³⁵See OMB Circular A-11, section 44.

³⁶See *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4, for a full discussion of Federal cost accounting principles and standards.

³⁷An example of an investment with a split purpose is a grant issued to a teaching hospital to perform both medical education and medical research.

³⁸The research and development outputs and outcomes should be the same as those measured for the Government Performance and Results Act (GPRA) and the budget and will be reported in a Statement of Program Performance Measures as described in Appendix 1-F to *Entity and Display*, SFFAC No. 2.

justify continued treatment of expenses as investments until outcome data are available. Definitions and characteristics of outputs and outcomes follow.

- “Output” - A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. They shall have two key characteristics: (1) they shall be systematically or periodically captured through an accounting or management information system, and (2) there shall be a logical connection between the reported measures and the program’s purpose. In research and development programs, this might consist of data for the year concerning the number of new projects initiated, the number continued from the prior year, the number completed and the number terminated. It also might consist of such quantitative measures as bibliometrics (for example, publication counts, citation counts and analysis, and peer evaluation); patent counts and analysis; and science “indicators” that assess the ongoing vitality of the research (for example, statistics on scientific and engineering personnel, graduate students and degree recipients by field and sector).³⁹
- “Outcome” - An assessment of the results of a program compared to its intended purpose. Because of the difficulty of measuring such results for research and development programs in financial, economic, or quantitative terms, outcome data for such programs are expected to consist typically of a narrative discussion of the major results achieved by the program during the year, along the following lines:
 - *Basic Research* - an identification of any major new discoveries that were made during the year;
 - *Applied Research* - an identification of any major new applications that were developed during the year; or
 - *Development* - the progress of major developmental projects including the results with respect to projects completed or otherwise terminated during the year and the status of projects that will continue.

³⁹*Research Funding as an Investment: Can We Measure the Returns?*, A Technical Memorandum, Congress of the United States, Office of Technology Assessment (Apr. 1986).

The information provided concerning outcomes should be chosen to provide, in concise form, a plausible basis for judging the extent to which the program is achieving its purpose.

Minimum Reporting

100. Minimum reporting shall consist of the following:

- The annual investment⁴⁰ made in the year ended on the balance sheet date as well as in each of the 4 years preceding that year shall be reported. If data for additional years would provide a better indication of investment, reporting of the additional years' data is encouraged. In those unusual instances when entities have no historical data, only current reporting year data need be reported. Reporting shall be at a meaningful category or level, for example, a major program or department. Reporting of major investments at the entity level shall be more specific than at the governmentwide level.
- In some cases, the information called for above will not be available because certain entities have maintained records on the basis of outlays rather than expenses. For such entities to reconstruct their accounts on the basis of expense data may be impracticable. Agencies in this situation will continue to report historical data on an outlay basis for any years for which reporting is required and for which expense data are not available. If neither historical expense nor outlay data are available for each of the 5 years, entities need report expense data for only the current reporting year and such other years as available. At the end of 5 years, however, the agency will be able to report the expenses to be categorized as research and development rather than the outlays for each of the preceding 5 years.
- A narrative description of major research and development programs shall be included.

⁴⁰As defined in this standard, "annual investment" includes more than the annual expenditure reported by character class for budget execution. "Annual investment" is the full cost of the investment. Full cost shall be measured and accounted for in accordance with *Managerial Cost Accounting Concepts and Standards*, SFFAS No. 4.

Recommended
Reporting

101. Reporting of the amount of significant state, local, private, or foreign total contributions to shared or joint programs is encouraged, but is not required. If it is known, however, that other contributions in a significant amount were made, that fact (for example, expressed as a percentage of the total program) may be reported even if the exact amount of the contribution is not known.

**Chapter 8: Current
Services
Assessment**

[Chapter 8, par. 102-108, rescinded by SFFAS No. 25]

Appendix A: Basis For Conclusions

109. This appendix provides a discussion of the more significant comments that the Board received from respondents to the exposure draft, *Supplementary Stewardship Reporting*, dated August 1995 and from testimony at a public hearing on the exposure draft that was held December 5, 1995.
110. Responses overall were generally favorable to the concept of reporting stewardship information. In some cases, respondents had questions about the specific reporting requirements or requested clarification on particular items. Where feasible, these areas were addressed or clarified in the final standards in this Statement. In the case of issues raised by the respondents, this appendix explains the basis of the Board's conclusions.

The Nature Of Stewardship Reporting

111. The exposure draft presented the Board's approach to reporting in a manner other than is done in the basic financial statements for those items that it has categorized as stewardship items. As the Board stated in the Introduction and Background chapter of this Statement, it believes that these stewardship items warrant specialized reporting to highlight their importance and to portray them in additional ways than provided by financial accounting. The Board designated a new category of reporting to highlight the unique nature of stewardship reporting, Required Supplemental Stewardship Information (RSSI).
112. Some respondents believed that, although reporting on stewardship items might be warranted, a separate manner of reporting might not. They believed that stewardship reporting could be accommodated either within the basic financial statements, for example, as a note, or as Required Supplemental Information (RSI). They did not see the need for the separate category of RSSI.
113. The Board, however, believes that a new category for reporting on stewardship items is more appropriate. If stewardship information were required to be reported in a note to the basic financial statements, it would be subject to the same level of audit scrutiny as that of the basic financial statements. Since some of the stewardship information is non-financial, for example, physical units, and other data is based on projections or assumptions, the same degree of audit coverage as that of the basic financial statements for these items may not be appropriate. Such data is not drawn directly from the financial

records. Thus reliance on financial records for audit backup would not be feasible.

114. On the other hand, the Board believes that certain stewardship information should receive more audit scrutiny than it would if it were RSI. For RSI, the auditor reviews the data for overall compliance with associated guidance and for consonance with the basic financial statements. The auditor usually provides in-depth review of the RSI only if there appears to be some problem with the data. If he or she believes that the data is not fairly presented, the auditor still may issue a clean opinion on the basic financial statements while noting that there are problems with the RSI.
115. Therefore, the Board has proposed that a new category, RSSI, be designated to cover stewardship reporting. By developing this new category, it is anticipated that audit standards will be developed to address the specific items in that category. Although the Board does not have authority to set audit standards, it established RSSI with the expectation that OMB and GAO will, in collaboration, determine appropriate audit procedures for this information.

Social Insurance

116. Consideration of guidance for the recognition, measurement and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The Board notes the strength of feelings of respondents and commentators, some of whom believe a liability should be recognized for amounts that will be paid in future periods to or on behalf of current or future program beneficiaries and others who believe that there is no obligation associated with these programs that meets the definition of a liability, other than amounts due and payable at the end of an accounting period; additionally, some favor disclosure of projected data relating to the magnitude of the present value of future net benefit payments at a particular date while others favor cash flow information for a long period of time. The Board notes too the magnitude and complexity of these programs and the extreme sensitivity of projections relating to the programs to assumptions whose range of possibilities is large. More importantly, the Board notes that social insurance programs are presently being studied and discussed frequently and seriously within government and by the public; a report and recommendations are expected shortly from the

1994-95 Quadrennial Advisory Council on Social Security. The prospects of significant changes to the programs are reasonably high.

117. After deliberating the issue, the Board has concluded that additional investigation and further deliberation is required and has directed the FASAB staff to continue to research social insurance issues focusing especially on: identifying the characteristics of programs which should cause them to be subject to the guidance provided in a Statement on Social Insurance; the appropriate display of information in the financial statements; the identification of additional information, if any, which should be required for social insurance programs; the means for measurement of financial data included in such additional information; and, the desirability of nonfinancial indicators (ratios of data to GDP or “covered payroll”) to describe the status of programs or the implications of potential changes to or needs of the programs. The Board has instructed the staff to be mindful of all current developments in structuring its research and its recommendations.

Expensing Stewardship PP&E

118. Echoing their earlier comments to the Board’s Exposure Draft, *Accounting for Property, Plant, and Equipment*, some respondents expressed concern that expensing rather than capitalizing costs associated with stewardship PP&E would lessen the value of the operating statement as a tool for performance measurement since it would overstate the cost in the year an asset is acquired.
119. The Board, however, believes that capitalizing and depreciating stewardship PP&E provides information that is of little usefulness. Stewardship PP&E includes heritage assets, Federal mission PP&E, and stewardship land. Period costs related to stewardship PP&E are of diminished usefulness because of uncertain useful life (e.g., heritage assets, Federal mission PP&E), uncertain historical cost basis (e.g., stewardship land), or probability of being destroyed in use (e.g., Federal mission PP&E). Therefore, the Board believes that attempting to capitalize and depreciate stewardship PP&E is not warranted. It believes that reporting on information related to the existence and the condition of the stewardship PP&E has more relevance to decision-makers and other users of the financial report.

Costing Of Federal
Mission PP&E
[SFFAS 11]

120. Respondents to the Board's question on whether the alternatives of presenting costs of Federal mission PP&E in terms of either total (historical) or latest acquisition cost generally believed that both options should not be allowed. Some believed that use of alternative methods would not ensure consistency in reporting. Others believed that only total (historical) costs should be used. Still others believed that total (historical) cost should be the long-term goal, with the use of latest acquisition cost allowed only until such historical cost data would be available.
121. The Board, however, recognizes that significant practical problems may arise if an agency is compelled to adopt a specified costing approach for reporting stewardship assets, and that such cost approach would not be used for computing the net cost of operations. Therefore, it believes that its decision to accept either the historical cost or latest acquisition cost method is appropriate. However, it also emphasizes that once a method is chosen, an entity should switch to the other method only with appropriate justification.

Reporting Expense Or
Outlay Data

122. The standards require that expense data be reported for investments in human capital, research and development, and nonfederal physical property. The standards also provide for a period of 5 years to transition to reporting expense data for those agencies that currently maintain only outlay data. Some Board members suggested that since some agencies currently maintain only outlay data, requiring that only outlay data be reported might be more practical. However, the responses reflected a clear consensus for reporting expenses, with little or no support for reporting outlays only, and a minority preferring to report both expenses and outlays. Therefore, the standards, as proposed, remain unchanged.

Request For More
Specificity In Reporting
Requirements

123. When the Board developed the standards for stewardship reporting, its intention was to provide overall guidance on definitions, recognition, measurement, and minimum and recommended reporting. This broad guidance was intended to provide the basic reporting requirements while allowing each entity maximum flexibility in such areas as determining what constitutes the individual stewardship items for that entity, which costs are directly attributable to the stewardship item, and how best to report on multi-use items so

that users will gain the best picture of the entity's financial and performance information.

124. The Board believes that the desire for more specific guidance expressed by several respondents stems from the belief that without such guidance, an entity's determination of how to apply the standards could be questioned. Nevertheless, the Board reiterates its position that entities should be provided maximum flexibility when applying the stewardship standards. However, entities should make the determination of how best to apply the stewardship standards based on a thorough analysis of their individual entity, including its mission, financial practices, and the impact of its mission and operation on financial report users and on the Nation. Finally, all entity determinations of the applicability of stewardship standards should be thoroughly documented.

**Issues For Which
Changes Were Made To
The Proposed Standards**

125. **Multiple Category Reporting.** Some respondents were concerned that there would be double counting if, as proposed by the standards, some stewardship items would be reported in two separate categories; for example, Yellowstone National Park would be reported as a heritage asset and as stewardship land.
126. Reporting supplementary stewardship information in two categories will not be deemed double counting. This is because where multiple reporting is required, the units of measure are different for each of the stewardship categories. In the example above, Yellowstone National Park would be reported under a category, such as "National Parks," as *one of the total number* of heritage assets under the auspices of the Department of the Interior; it also would be reported by the *number of acres* that it occupies under the stewardship land category for the Department. To clarify this point, the discussion of the process of multiple reporting was expanded in the statement to explain that the Board does not consider this reporting as double counting.
127. **Reporting the Fair Value for Stewardship PP&E Transferred to State or Local Governments.** Many respondents questioned the need for, and the cost/benefit of, requiring that the fair value of stewardship PP&E transferred to state and local governments be reported. They stated that monetary values for stewardship PP&E are not required to be reported because such values are either difficult to obtain (e.g., lack of historical cost data on land acquired at the birth of

the Nation) or not meaningful (e.g., the historical cost to build the Washington Monument). Therefore, they questioned the cost/benefit of requiring that the fair value of stewardship property transferred to state and local governments be determined and reported.

128. The Board agreed that the fair value of stewardship property transferred to state and local governments need not be determined and reported. The standards have been revised to require a description of the property transfer transaction; if the fair value is known, nothing would preclude reporting it.

**Effective Date For
Consolidated Financial
Statements**

129. In considering required reporting of stewardship information, the Board became increasingly aware of the need to be highly selective in proposing requirements for the consolidated financial report of the Federal Government. It recognized the potential for implementation problems in the first few years after the effective date of this statement. In addition to the normal problems associated with adapting to new standards, several of these standards provide for a transition period during which agencies may or, in some cases, may not report investments in human capital, research and development and nonfederal physical property; if investments are reported for each of five years as called for in this statement, they may be reported for earlier years during the transition period on the basis of either outlays or expense. The merit of reporting the aggregate of information prepared on different bases is questionable.
130. Further, the information required to be reported by these standards goes beyond that customarily accompanying financial reports of governments or commercial enterprises. Standards related to heritage assets and stewardship land call for reporting in terms of physical units (e.g., number of parks or acres of land) rather than in terms of historical cost. Implementation problems are foreseen at the consolidated statement level because of differing measures. Also, the Board is concerned with the possibility of establishing requirements so detailed as to render the consolidated financial report unwieldy, unfriendly to the potential user and obfuscating of important information.
131. Because of these possible implementation problems and the need to consider other disclosures or presentations, the Board expressed a

desire for further deliberations relative to the consolidated financial report of the Federal Government.

132. Accordingly, the effective date of this statement will be for fiscal years beginning after September 30, 1997 as it relates to financial statements of component units of the Federal Government; this same effective date applies to chapter 8 as it relates to the consolidated financial statements of the Federal Government. The effective date of the statement as it applies to the consolidated financial statements, except for chapter 8, is deferred pending further deliberations of the Board. In the interim, the consolidated financial reports should include such summary or selected information as is feasible. Experimentation is encouraged, as is the reporting of such additional information as will enhance the financial report.

**Reporting Of
Information Not
Specifically Addressed
In The Standards**

133. Some respondents requested that the standards provide for reporting additional information, such as transfers of stewardship property to foreign governments, stewardship land sold to the private sector, the Federal Government's interest in such things as property held by nonfederal entities or patents generated through Federal research and development funds, and foreign contributions to Federal programs.
134. In developing the standards for stewardship reporting, the Board concentrated on providing guidance in the principal areas of stewardship resources that have materiality for the majority of Federal entities and for the consolidated financial reporting for the Nation. The Board's intent was to ensure that these significant areas, if material for an entity, would be reported regularly and in a consistent manner.
135. In some cases, an entity may have other resources or obligations that were not specifically addressed in the stewardship standards, but that the entity believes may be material to the presentation of its stewardship information. In such cases, if the reporting of such additional data would be useful and relevant to readers, and would provide a better indication of the resources and obligations of the entity, the Board encourages such reporting.

Appendix B: Sample Reports

NOTE: The sample report sections in Appendix B are intended to illustrate the type of reporting contemplated by the Board. Certain data are taken from various reports for one or more recent years and are "actual data." Other data have been estimated by judgmentally extrapolating from "actual data." Still other data and program references have been fabricated and are hypothetical. Therefore, readers should not rely on the validity of the data in the sample reports.

Specific form and content guidance on financial reports will be provided by OMB.

Nonfederal Physical Property

Annual Stewardship Information For The Fiscal Year Ended September 30, 199Z

Annually, the Federal Government provides funding to state and local governments for the purchase, the construction, or the major renovation of physical property owned by state and local governments; additionally, from time to time, the Federal Government transfers PP&E to these governments in exchange for less than fair value. These grants and transfers relate to roads and transportation systems, clean water and environmental projects, and other projects for the common good.

The investments in nonfederal physical property in the 5 years from 199V to 199Z were as follows:

Nonfederal Physical Property Annual Stewardship Information for the Fiscal Year Ended September 30, 199Z

Dollars in billions

	199V	199W	199X	199Y	199Z ^m
Transportation	\$19.0	\$20.0	\$20.0	\$22.0	\$23.0
Natural Resources and Environment	3.7	4.0	3.9	3.7	4.2
Community and Regional Development	4.9	4.3	4.5	5.6	6.3
Administration ⁿ	2.2	2.3	2.4	2.5	2.7
Total	\$29.8	\$30.6	30.8	\$33.8	\$36.2

^mIncluded as expenses in calculating net cost.ⁿExpenses of administration include an appropriate allocation of agency overhead costs.

In addition to the transfers shown above in the “Community and Regional Development” category, the fair value of land and facilities associated with former military installations that were transferred to local governments approximated \$40 million in 199Y and \$52 million in 199Z.

Certain transportation and environmental programs involving Federal investments of \$22 billion and \$4 billion, respectively, in 199Z required matching support by local governments of about 20 percent and 80 percent of the Federal grants.

Human Capital

Annual Stewardship Information For the Fiscal Year Ended September 30, 199Z

Federal investment in human capital comprises those expenses for education and training programs for the general public that are intended to increase or maintain national economic productive capacity. It does not include expenses for internal Federal education and training. Expense data are expressed in nominal dollars for the fiscal year being reported upon and the preceding 4 fiscal years.

Following is a summary of stewardship data for the program entitled, Transition Training for Former Navy Contractor Personnel⁴¹, for the 5 fiscal years ending September 30, 199V through 199Z:

Program: Transition Training for Former Navy Contractor Personnel

	199V	199W	199X	199Y	199Z ^o
Program Expenses (\$000s)^p					
Counseling	\$ 373	\$ 508	\$ 740	\$ 980	1,053
Education	786	2,381	3,860	5,621	7,053
Administration ^q	847	1,165	1,224	1,367	1,584
Total	\$ 2,005	\$ 4,054	\$ 5,824	\$ 7,968	9,690

Program Outputs

Participants Counseled	310	415	592	784	823
Participant Years of Training Delivered	162	486	787	1,147	1,432

^oIncluded as expenses in calculating net cost.

^pExpenses are reported on an accrual basis, including contractual amounts due for counseling services delivered and educational costs incurred by participants.

^qExpenses of administration include an appropriate allocation of agency overhead costs.

Program Outcomes

Preliminary data appear to confirm that the services provided by the program accelerate the transition of participants into alternative employment; some savings are realized in the Unemployment Insurance Fund. A follow-up survey of the 415 participants in the year 199W showed that 80% were earning at least as much as they were earning in their Navy contractor positions. A more extensive evaluation, including an assessment of effects on long-term earnings, is currently planned for completion in 1999.

Narrative Discussion

This program was authorized in 19XX (by P.L. XX-XXX) to ease the transition into other civilian positions of skilled technical, administrative, and managerial personnel who are no longer needed in certain shipyards because of declining orders for Navy ship construction.

⁴¹This hypothetical program is for illustration only.

Eligibility is limited to those who have been employed at designated shipyards for at least 5 years, but who are not yet eligible for retirement benefits. Participants receive intensive counseling to help them develop individual transition plans. This counseling is provided by a private job placement service under contract. Participants are then reimbursed up to \$5,000 per year for up to 2 years, not to exceed 80 percent of the cost of the cost of tuition, fees, books, and other student materials required for attendance at approved educational institutions.

An additional increment of education or technical training is expected to reduce the period of transitional unemployment and increase the subsequent earnings of participants.

Research and Development

Annual Stewardship Information For the Fiscal Year Ended September 30, 199Z

Federal investment in research and development comprises those expenses for basic research, applied research, and development that are intended to increase or maintain national economic productive capacity or yield other benefits. Expense data are expressed in nominal dollars for the fiscal year being reported upon and the preceding 4 FYs.

Following is a summary of stewardship data for the Ceramic Materials Research Program⁴² for the 5 fiscal years ending September 30, 199V through 199Z:

⁴²This hypothetical program is for illustration only.

Program: Ceramic Materials Research Program

Dollars in millions

	199V	199W	199X	199Y	199Z ¹
Program Expenses^s					
Basic Research	\$ 106	\$ 124	\$136	\$ 132	\$ 143
Applied Research	93	101	107	118	121
Development ^t	46	62	73	68	82
Administration	14	16	17	19	21
Total	\$ 259	\$ 303	\$ 333	\$ 337	\$ 367

¹Included as expenses in calculating net cost.^sExpenses are reported on an accrual basis and include an allocation of overhead costs.^tDevelopment grants are for a fixed amount, not to exceed 50 percent of the cost of the project.

Program: Outputs and Outcomes

	199V	199W	199X	199Y	199Z
Interagency Agreements and Contracts					
New	45	38	41	37	44
Continuation	28	52	55	61	68
Articles in Journals	9	12	23	34	41
Patents funded R&D	3	8	14	18	21
Rights to Inventions from funded R&D ^u	0	1	0	3	2

^uIndicated inventions financed with federal funds to which the government has patent rights, in accordance with the Bayh-Dole Act.**RESEARCH AND DEVELOPMENT SAMPLE REPORT (continued)**

Programs Outcomes:

The increasing number of articles published on the basis of funded research, including announcements of several newly discovered properties of certain composite ceramics, is evidence of the utility of this part of the program. The number of patents emerging from the program is also increasing, primarily from the development component of the program.

Narrative Discussion:

This program was authorized in 19XX (by P.L. XX-XXX) to accelerate the development of this industry in the United States. The research element of the program operates through interagency agreements with the Federal laboratories and grants to university researchers. The researchers are selected through peer review procedures. The development component provides grants to private firms to develop improved manufacturing procedures for ceramic materials-based products and to accelerate the development of marketable products incorporating advanced ceramic materials.

**Appendix C:
Glossary**

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Statement of Federal Financial Accounting Standards 9: Deferral of the Effective Date of Managerial Cost Accounting Standards for the Federal Government in SFFAS No. 4

Status

Issued	March 3, 1997
Effective Date	For fiscal years ending September 30, 1998 and thereafter.
Volume II References	Managerial Cost Accounting (M20)
Interpretations and Technical Releases	None.
Affects	SFFAS 4.
Affected by	None.

Summary

This statement is issued to amend the effective date of the standards in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, issued in July 1995. The original effective date was for reporting periods beginning after September 30, 1996. The amended effective date is for periods beginning after September 30, 1997.

In July 1997, the Federal Accounting Standards Advisory Board (the Board) received a request from the CFO Council for a two year deferral of the effect date of the managerial cost accounting standards to fiscal year 1999. The CFO Council representatives stated that many agencies have not been able to implement the managerial cost accounting standards during the two years since SFFAS No. 4 was issued, due to the following reasons: (a) the Joint Financial Management Improvement Program (JFMIP) has not issued its Managerial Cost Accounting System Requirements, (b) the CFO Council has not issued its managerial cost accounting guide, and (c) most agencies do not have adequate cost accounting systems in place. After considering the CFO Council's request, the Board reluctantly agreed to propose deferring the effective date of the managerial cost accounting standards for one year to fiscal year 1998 and issued an Exposure Draft (ED) for public comments. Most responses to the ED were in favor of the proposal.

After reviewing the comments to the ED, the Board decided to recommend the one year deferral. At the same time, it reemphasizes the importance of managerial cost accounting to Federal program and financial management. The Chief Financial Officers Act of 1990 requires the development of cost information and the systematic measurement of performance. Reliable and relevant cost information is indispensable for implementing the requirements of the Government Performance and Results Act of 1993. The Board urges Federal entities and their CFOs to give priority to implementing the requirements in SFFAS No. 4.

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Introduction

1. This statement is issued to amend the effective date of the managerial cost accounting standards prescribed in Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*,¹ which was issued in July 1995. The standards in SFFAS No. 4 were effective for reporting periods beginning after September 30, 1996. The amended effective date is for reporting periods beginning after September 30, 1997.
2. In August 1997, the Board issued an exposure draft (ED)² in which it proposed a deferral of the effective date of managerial cost accounting standards. The ED was issued after considering a request presented to the Board by the CFO Council. (See Attachment: Letter from the CFO Council, dated June 26, 1997.) In their request, the CFO Council representatives stated that most agencies were having difficulties in implementing the cost accounting standards because (a) the Managerial Cost Accounting System Requirements have not yet been issued,³ (b) the CFO Council has yet to issue a managerial cost accounting guide,⁴ and (c) most agencies do not have adequate cost systems in place. The CFO Council representatives requested that the effective date of SFFAS No. 4 be deferred for two years to reporting periods that begin after September 30, 1998. They also requested that “relevant portions” of SFFAS 7, *Accounting for Revenue and Other Financing Sources*, be delayed to that same date.
3. After considering the reasons presented by the CFO Council, the Board reluctantly proposed a one year delay for SFFAS No. 4, to reporting periods beginning after September 30, 1997, and issued the ED for that proposal. No delay was proposed for any part of SFFAS

¹In addition to managerial cost accounting standards, SFFAS No. 4 also contains managerial cost accounting concepts which provide general guidance for managerial cost accounting but do not constitute specific requirements. The effective date does not apply to those concepts.

²The ED was published in FASAB News issue No. 45, August 1997.

³In April 1997, JFMIP issued an Exposure Draft on Managerial Cost Accounting System Requirements, which is yet to be finalized as of this date.

⁴The CFO Council’s Governmentwide Cost Accounting Work Group issued an Exposure Draft of the Managerial Cost Accounting Implementation Guide on June 30, 1997, which has not been finalized as of this date.

No. 7, which is effective for reporting periods beginning after September 30, 1997. The Board noted that cost accounting is required by the Chief Financial Officers Act of 1990 (the CFO Act), and reliable cost information is necessary for implementing the Government Performance and Results Act (GPRA) of 1993. The Board also observed that the cost accounting standards allow Federal entities without a sophisticated cost accounting system to use cost studies or cost finding techniques to meet the requirements of the cost accounting standards. The Board further observed that during the past two years since SFFAS No. 4 was issued, most agencies should have had sufficient time to develop at least the basic cost accounting processes as described in paragraph 71, SFFAS No. 4.

4. The Board received 26 responses to the ED. Most respondents supported the Board's proposal for a one year deferral of the cost accounting standards in SFFAS No. 4 to fiscal year 1998. After considering the comments, including those opposed to any delay and those favoring a two year delay, the Board decided to recommend the one year deferral to the FASAB principals.

The Amended Effective Date

5. The effective date of the managerial cost accounting standards provided in paragraph 30, SFFAS No. 4, is amended as follows:

“The managerial cost accounting standards prescribed in SFFAS No. 4 shall be effective for fiscal periods beginning after September 30, 1997. Earlier implementation is encouraged.”

Basis For Conclusion

Reasons for the Delay

6. After considering the CFO Council's presentation and the responses to the ED, the Board is convinced that as of the end of fiscal year 1997, most agencies were not ready to produce cost information as required in the cost accounting standards. As described in CFO Council's request and in the responses to FASAB's ED, many agencies need more time and guidance to define responsibility segments and to develop procedures for accumulating and assigning costs. They also said that they need more time to upgrade or expand their accounting

systems, and to promote the use of cost measures among program and financial managers.

7. Most respondents stated that the one year delay should not significantly affect implementation of the Government Performance and Results Act of 1993 (GPRA). With regard to the GPRA requirement that Federal agencies measure and report outputs, outcomes, and related costs by segments for fiscal year 1999 and thereafter, the respondents stated that with the one year deferral of the cost accounting standards, agencies will have time to align their cost accounting structures with the GPRA measures.
8. Under these circumstances, the Board concluded that a one year deferral would be appropriate. The deferral would provide the Federal entities with an opportunity to engage top-level agency officials, budget analysts, and program and financial managers in the processes of developing, collecting and using cost information.
9. Several respondents reiterated the CFO Council's original request for a two year delay to fiscal year 1999, on the grounds that their systems would not be ready within fiscal year 1998. The Board cannot agree with this request. It believes that cost accounting capability must be developed in time to fully support the GPRA reporting. The Board thus urges Federal entities to give implementation of SFFAS No. 4 a high priority and take immediate actions to define and structure responsibility segments and develop costing methodologies.
10. Several respondents said that, after the effective date, Federal entities should be given a transitional period in which they could have flexibility to develop and improve their cost accounting systems and procedures gradually. The Board disagrees with this approach for two reasons: (a) such a transitional period would add uncertainty to the required implementation, (b) a degree of flexibility for developing cost accounting systems and procedures is already built in the standards, and thus a transitional provision is not necessary.
11. The Board notes that the standards already provide a sufficient degree of flexibility to Federal entities. For example, paragraph 70, SFFAS No. 4, provides that managerial cost accounting processes can be accomplished through the use of a cost accounting system or the use of cost finding techniques or other cost studies and analyses. Paragraph 266 further provides that "Federal agencies can take a

gradual approach to the development of cost systems, if necessary, while developing basic cost information through other means in the short run.” Federal agencies are expected to refine and improve their costing procedures, methods, and systems, as they gain experience in using cost information (paragraph 24, SFFAS No. 4). Those who are not familiar with the criteria of implementation should review the standard on “Requirement for Cost Accounting” in paragraphs 67 through 76, SFFAS No. 4.

12. Several respondents were opposed to any deferral. They pointed out that the original effective date was more than two years after SFFAS No. 4 was issued, and it provided enough lead time for agencies to implement the cost accounting standards. They stated that if the delay in implementing the standards was caused by a lack of action, a mere deferral could only cause continued inaction. The Board recognizes that many agencies have made significant progress in improving general accounting and financial reporting. The Board anticipates that the one year deferral will bring similar progress in implementing the cost accounting standards.

The Status of Interpretation No. 2

13. In January 1997, FASAB issued Interpretation No. 2, *Accounting for Treasury Judgment Fund Transactions*. The Treasury Judgment Fund was established by Congress to pay, in whole or part, the court judgments or settlements negotiated by the Justice Department on behalf of Federal agencies. Interpretation No. 2 requires that if a loss in litigation is probable and estimable, the reporting entity in the litigation should recognize an expense and liability for the full amount of the estimated loss, although the loss may be paid by the Treasury Judgment Fund. The Interpretation reflects the cost principle in SFFAS No. 4, and is based on the principle of recognizing contingent liabilities in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*. The Interpretation was made effective for reporting periods beginning after September 30, 1996, the same as SFFAS No. 4 and No. 5.
14. The ED raised a question: If SFFAS No. 4 were deferred as proposed, should Interpretation No. 2 be deferred as well? Some respondents believed that Interpretation No. 2 should be deferred to fiscal year 1998. They were concerned with difficulties in collecting reliable information to estimate the probable litigation losses. Other respondents, however, did not believe that Interpretation No. 2 should

be delayed for the following reasons: (1) the recognition of litigation losses and liabilities is not dependent on cost accounting capabilities, and (2) the recognition of contingent liabilities and losses is required by SFFAS No. 5, which is not deferred.

15. The Board agrees with the view that Interpretation No. 2 is based on the principle provided in SFFAS No. 5 of recognizing contingent liabilities, and that its implementation should not be deferred. As with all matters in litigation, the data should come from agencies' management and their legal offices and the Department of Justice. Deferring the Interpretation is not a positive solution to the data gathering problem.

The Status of SFFAS No. 7

16. Those respondents who preferred a two year delay for SFFAS No. 4 also reiterated the CFO Council's original request to defer certain cost-related portions of SFFAS No. 7, *Accounting for Revenue and Other Financing Sources* to fiscal year 1999. While no specific paragraphs were mentioned, they were concerned with the requirements for matching costs with revenues by sub-organizations (equivalent to responsibility segments). (See, for example, paragraphs 116 through 126, SFFAS No. 7.) They stated that they are modifying their systems to accommodate those requirements, but their systems work could not be completed in fiscal year 1998.
17. With the effective date of SFFAS No. 4 deferred to fiscal year 1998, the cost accounting standards should be implemented and the necessary cost information should be accumulated to support implementation of SFFAS No. 7 for that year. Thus, the Board is not convinced that SFFAS No. 7 needs to be deferred. The Board believes that it is highly important to relate SFFAS No. 4 and No. 7 to measuring program performance and results. While the standards in SFFAS No. 4 provide more detail in cost concepts, procedures, and methodologies, SFFAS No. 7 brings cost information into focus in measuring the net results of programs and activities. The integrated implementation of those two statements is crucial for meeting the objectives of financial reporting by Federal entities and for implementing the GPRA requirements.

**Attachment: Letter
From CFO Council**

**United States Government
Chief Financial Officers Council**

Jun 26, 1997

Mr. Dave Mosso, Chairman
**Financial Accounting Standards Advisory Board
441 G Street, N. W.
Washington, D.C. 20548**

Dear Mr. Mosso:

The Chief Financial Officers Council (CFOC) recognizes the importance for Federal agencies to move forward and implement the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government. We believe this standard, effective for reporting periods after September 30, 1996, is essential to support the cost effectiveness of mission performance and to provide full accountability to taxpayers over our resources.

The Council is concerned, however, over the impediments and difficulties most agencies are having in implementing this standard. These difficulties exist due to the following:

- The Managerial Cost Accounting System Requirements have not yet been issued;
- The Managerial Cost Accounting Guidance, which will help agencies in implementing SFFAS No.4, will not be issued until later this Summer;
- Adequate cost Systems are not in place to meet the requirements of the Results Act to provide program cost and performance information in an agency's annual performance report. Agency Performance Reports required under the Results Act are not due until March 2000. It will be several years before agencies will have the necessary cost systems in place.

For the above reasons, the Council requests FASAB to change the effective date for SFFAS No. 4, and in relevant portions of its companion, SFFAS No. 7, Accounting for Revenue and Other Financial Sources (effective for reporting periods after September 30, 1997), to the "revised effective date"

for reporting periods after September 30, 1998. Given that the systems and cost accounting guidance needed by agencies have not been issued and only 4 months remain in this fiscal year, we feel this request is justified. Additionally, this request is further supported by the fact that the Results Act Performance Report requirements are not statutorily required until FY 1999.

While we recommend a change in the effective implementation date, we fully acknowledge and support the critical importance of the cost and revenue standards. Based on the importance and usefulness of anticipated cost information for internal agency management and other purpose, in addition to the significant benefits that are often derived from early implementation of Federal accounting standards, we nevertheless encourage Federal agencies to implement these standards as soon as practicable based on the capabilities of agency systems and the maturity of agency cost accounting practices. While such early, voluntary implementation is encouraged, the Council requests that the Board change the mandatory implementation date to fiscal periods after September 30, 1998.

Specific questions regarding this request may be directed to Frank M. Sullivan, Chair, CFOC Cost Accounting Committee, at (202) 273-5504 or via E-Mail at "fs@mail.va.gov".

Sincerely,

(SIGNED)

Arnold G. Holz
Executive Vice-Chair
Chief Financial Officers Council

Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software

Status

Issued	June 1998
Effective Date	For periods beginning after September 30, 2000
Volume II References	Software (S50)
Interpretations and Technical Releases	None.
Affects	SFFAS 10, paragraph 7, rescinds SFFAS 6, paragraphs 27-28, and provides a comprehensive standard for accounting for internal use software.
Affected by	None.

Summary

This statement provides accounting standards for internal use software. Under the provisions of this statement, internal use software is classified as “general property, plant, and equipment” (PP&E) as defined in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*. This statement includes software used to operate a federal entity’s programs (e.g., financial and administrative software, including that used for project management) and software used to produce the entity’s goods and services (e.g., air traffic control and loan servicing).

Internal use software can be purchased off-the-shelf from commercial vendors and can be developed by contractors with little technical supervision by the federal entity or developed internally by the federal entity. SFFAS 6 specified treatment for internally developed software different from that for commercial off-the-shelf (COTS) software and contractor-developed software. SFFAS 6 addressed COTS and contractor-developed software generally, providing that they were “subject to its provisions.” On the other hand, specific provision was made for internally developed software.

SFFAS 6 prohibited the capitalization of the cost of internally developed software unless management intended to recover the cost through user charges, and the software was to be used as general PP&E. For capitalizable software, capitalization would begin after the entity completed all planning, designing, coding, and testing activities that are necessary to establish that the software can meet the design specifications.

At the conclusion of the PP&E project the Federal Accounting Standards Advisory Board discussed whether the standard for internally developed software should also apply to contractor-developed software. Also, some users of SFFAS 6 were unsure how to apply it to COTS and contractor-developed software. The Board decided, in December 1996, to review the issue and develop a separate standard for internal use software.

This standard requires the capitalization of the cost of internal use software whether it is COTS, contractor-developed, or internally developed. Such software serves the same purposes as other general PP&E and

functions as a long-lived operating asset. This standard provides guidance regarding the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

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Introduction

Purpose

1. This statement provides accounting standards for internal use software¹ used by federal entities. Federal entities purchase commercial “off-the-shelf” (COTS) software, hire contractors to develop substantially all of the desired software (contractor-developed), or develop software internally using their own employees, with or without a contractor’s assistance (internally developed).

Scope

2. This statement establishes accounting standards for the cost of software developed or obtained for internal use. These include the cost of
 - software used to operate an entity’s programs (e.g., financial and administrative software, including that used for project management),
 - software used to produce the entity’s goods and to provide services (e.g., air traffic control and loan servicing), and
 - software that is developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement.
3. This statement provides standards on accounting for software consisting of one or more components or modules. For example, an entity may develop an accounting software system containing three elements: a general ledger, an accounts payable subledger, and an accounts receivable subledger. Each element might be viewed as a component or module of the entire accounting software system. This standard may be applied to the total cost of the software or, when appropriate, to individual components or modules. For example, one software module may be implemented before others, in which case, the provisions of this standard for capitalization, amortization, etc., would apply to it separately.

¹The terms defined in the glossary will be in **boldface** when they first appear in the body of this document [see Appendix E, Consolidated Glossary]

Background

4. At the conclusion of the general property, plant, and equipment (PP&E) project, the Federal Accounting Standards Advisory Board (Board) discussed whether the standard for internally developed software should also apply to contractor-developed software. Also, some users of Statement of Federal Financial Accounting Standards (SFFAS) No. 6 were unsure of how to apply it to COTS and contractor-developed software. The Board decided in December 1996 to review the issue and develop a separate standard for internal use software.
5. In June 1997, the Board issued an exposure draft entitled *Accounting for Internal Use Software*. The Board received comments from 26 respondents and held a public hearing on December 18, 1997.

Materiality

6. The provisions of this statement need not be applied to immaterial items.

Effective Date

7. The provisions of this statement are effective for reporting periods that begin after September 30, 2000. Paragraphs 27 and 28 of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, which pertain to internally developed software, are rescinded upon this standard's issuance. Federal entities may continue their current accounting practices for internal use software for accounting periods beginning before October 1, 2000. Early implementation of this statement is encouraged.

**Internal Use
Software
Accounting
Standard**

Definitions

8. Software includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program. "Internal use software" means software that is purchased from commercial vendors "off-the-shelf," internally developed, or contractor-developed solely to meet

the entity's internal or operational needs. Normally software is an integral part of an overall system(s) having interrelationships between software, hardware, personnel, procedures, controls, and data.

9. This definition of internal use software encompasses the following:
- a. Commercial off-the-shelf (COTS) software: COTS software refers to software that is purchased from a vendor and is ready for use with little or no changes.
 - b. Developed software
 - (1) Internally developed software refers to software that employees of the entity are actively developing, including new software and existing or purchased software that are being modified with or without a contractor's assistance.
 - (2) Contractor-developed software refers to software that a federal entity is paying a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

Software Development Phases

10. Software's life-cycle phases² include planning, development, and operations. This standard provides a framework for identifying software development phases and processes to help isolate the capitalization period for internal use software that the federal entity is developing.

²There are no federal requirements regarding the phases that each software project must follow. The **life-cycle** phases of a software application described here are compatible with and generally reflect those in the Office of Management and Budget's (OMB) Circular A-130, *Management of Information Resources*, and *Capital Programming Guidance*; the Government Accountability Office's (GAO), *Measuring Performance and Demonstrating Results of Information Technology Investments* (GAO/AIMD-98-89, Mar. 1998); and the American Institute of CPAs's Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (Mar. 4, 1998). Successful software projects normally would have at least an initial design phase, an application development phase, and a post-implementation/operational phase. Also, software eventually would become obsolete or otherwise be replaced and therefore have a termination phase. Circular A-130 acknowledges that the "life cycle varies by the nature of the **information system**. Only two phases are common to all information systems—a beginning and an end. As a result, life cycle management techniques that agencies can use may vary depending on the complexity and risk inherent in the project." (A-130, "Analysis of Key Sections," p. 63).

11. The following table illustrates the various software phases and related processes. The steps within each phase of internal use software development may not follow the exact order shown below. This standard should be applied on the basis of the nature of the cost incurred, not the exact sequence of the work within each phase.

Preliminary design phase	Software development phase	Post-Implementation/operational phase
Conceptual formulation of alternatives ³	Design of chosen path, including software configuration and software interfaces ⁴	Data conversion
Evaluation and testing of alternatives	Coding	Application maintenance
Determination of existence of needed technology	Installation to hardware	
Final selection of alternatives	Testing, including parallel processing phase	

12. In the *preliminary design phase*, federal entities will likely do the following:
- a. Make strategic decisions to allocate resources between alternative projects at a given time. For example, should programmers develop new software or direct their efforts toward correcting problems in existing software?
 - b. Determine performance requirements (i.e., what it is that they need the software to do).
 - c. Invite vendors to perform demonstrations of how their software will fulfill a federal entity's needs.
 - d. Explore alternative means of achieving specified performance requirements. For example, should a federal entity make or buy

³See OMB Circular A-11, *Planning, Budgeting, and Acquisition of Capital Assets*; Supplement to Circular A-11, *Capital Programming Guide* (July 1997); and Circular A-109, *Major Systems Acquisitions*, par. 11, "Alternative Systems."

⁴See OMB Circular A-109, *Major Systems Acquisitions*, par. 13, "Full-Scale Development and Production."

the software? Should the software run on a mainframe or a client server system?

- e. Determine that the technology needed to achieve performance requirements exists.
 - f. Select a vendor if a federal entity chooses to obtain COTS software.
 - g. Select a consultant to assist in the software's development or installation.
13. In the *software development phase*, federal entities will likely do the following:
- a. Use a system to manage the project.
 - b. Track and accumulate life-cycle cost and compare it with performance indicators.
 - c. Determine the reasons for any deviations from the performance plan and take corrective action.
 - d. Test the deliverables to verify that they meet the specifications.
14. In the *post-implementation/operational phase*, federal entities will likely do the following:
- a. Operate the software, undertake preventive maintenance, and provide ongoing training for users.
 - b. Convert data from the old to the new system.
 - c. Undertake post-implementation review comparing asset usage with the original plan.
 - d. Track and accumulate life-cycle cost and compare it with the original plan.

Recognition, Measurement, And Disclosure

Software Used As General PP&E

15. Entities should capitalize the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services.⁵

Capitalizable Cost

16. For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.⁶ Such cost should be limited to cost incurred after
- a. management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function with an estimated service life of 2 years or more and
 - b. the completion of conceptual formulation, design, and testing of possible software project alternatives (the preliminary design stage).
17. Such costs include those for new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation manuals.
18. For COTS software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or

⁵General PP&E, as distinguished from **stewardship PP&E**, is defined in pars. 23-25, in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

⁶For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995), pars. 90-92. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

	contractor-developed software and otherwise make it ready for use should be capitalized.
Data Conversion Cost	19. All data conversion costs incurred for internally developed, contractor-developed, or COTS software should be expensed as incurred, including the cost to develop or obtain software that allows for access or conversion of existing data to the new software. Such cost may include the purging or cleansing of existing data, reconciliation or balancing of data, and the creation of new/additional data.
Cutoff For Capitalization	20. Costs incurred after final acceptance testing has been successfully completed should be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site.
Multiuse Software	21. The cost of software that serves both internal uses and stewardship purposes (“multiuse software”) should be accounted for as internal use software (e.g., a global positioning system used in connection with national defense activities and general operating activities and services).
Integrated Software	22. Computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly (e.g., airport radar and computer-operated lathes). The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.
Bundled Products And Services	23. Federal entities may purchase software as part of a package of products and services (e.g., training, maintenance, data conversion, reengineering, site licenses and rights to future upgrades and enhancements). Federal entities should allocate the capitalizable and noncapitalizable cost of the package among individual elements on the basis of a reasonable estimate of their relative fair values. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements should be expensed.
Capitalization Thresholds	24. Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software

programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system. That guidance should consider whether period cost would be distorted or asset values understated by expensing the purchase of numerous copies of a software application or numerous components of a software system and, if so, provide that the collective cost should be capitalized.

Enhancements

25. The acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities. For example, in an instance where the federal entity adds a capability or function to existing software for making ad hoc queries, the cost would be capitalized.
26. Enhancements normally require new software specifications and may require a change of all or part of the existing software specifications as well. The cost of minor enhancements resulting from ongoing systems maintenance should be expensed in the period incurred. Also, the purchase of enhanced versions of software for a nominal charge are properly expensed in the period incurred.
27. Cost incurred solely to repair a design flaw or to perform minor upgrades that may extend the useful life of the software without adding capabilities should be expensed.⁷

Impairment

POST-IMPLEMENTATION/OPERATIONAL SOFTWARE

28. Impairment should be recognized and measured when one of the following occurs and is related to post-implementation/operational software and/or modules thereof:

⁷However, in instances where the useful life of the software is extended, the amortization period would be adjusted.

The Board has considered the cost associated with modifying internal use software for the year 2000 (Y2K) and has determined that such cost should be charged to expenses as incurred, since it is a repair of a design flaw that allows existing software to continue being used. However, an enhancement could presumably provide enhanced capabilities and at the same time, as an integral part of the new code and other software enhancements, cure the Y2K problem. The total cost of such an enhancement should be capitalized rather than allocated between the Y2K cost and all other cost.

-
- the software is no longer expected to provide substantive service potential and will be removed from service or
 - a significant reduction occurs in the capabilities, functions, or uses of the software (or a module thereof).
29. If the impaired software is to remain in use, the loss due to impairment should be measured as the difference between the book value and either (1) the cost to acquire software that would perform similar remaining functions (i.e., the unimpaired functions) or, if that is not feasible, (2) the portion of book value attributable to the remaining functional elements of the software. The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. If neither (1) nor (2) above can be determined, the book value should continue to be amortized over the remaining useful life of the software.
30. If the impaired software is to be removed from use, the loss due to impairment should be measured as the difference between the book value and the net realizable value (NRV), if any.⁸ The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. The NRV, if any, should be transferred to an appropriate asset account until such time as the software is disposed of and the amount is realized.

DEVELOPMENTAL SOFTWARE

31. In instances where the managers of a federal entity conclude that it is no longer more likely than not that developmental software (or a module thereof) will be completed and placed in service, the related book value accumulated for the software (or the balance in a work in process account, if applicable) should be reduced to reflect the expected NRV, if any, and the loss recognized. The following are indications of this:
- Expenditures are neither budgeted nor incurred for the project.
 - Programming difficulties cannot be resolved on a timely basis.
 - Major cost overruns occur.

⁸Presumably, NRV will be zero for software. However, in the rare case that it is not zero, NRV should be recognized.

- Information has been obtained indicating that the cost of developing the software will significantly exceed the cost of COTS software available from third party vendors; hence, management intends to obtain the product from those vendors instead of completing the project.
- Technologies that supersede the developing software product are introduced.
- The responsibility unit for which the product was being created is being discontinued.

Amortization

32. Software that is capitalized pursuant to this standard should be amortized in a systematic and rational manner over the estimated useful life of the software. The estimated useful life used for amortization should be consistent with that used for planning the software's acquisition.⁹
33. For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing.
34. Any additions to the book value or changes in useful life should be treated prospectively. The change should be accounted for during the period of the change and future periods. No adjustments should be made to previously recorded amortization. When an entity replaces existing internal use software with new software, the unamortized cost of the old software should be expensed when the new software has successfully completed testing.

Disclosures

35. The disclosures required by SFFAS No. 6, paragraph 45, for general PP&E are applicable to general PP&E software. Thus, for material

⁹For example, federal agencies use the following planning guidance: OMB Circulars A-11, *Budget Planning, Budgeting, and Acquisition of Fixed Assets*; A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*; and A-109, *Acquisition of Major Systems*; OMB's *Capital Programming Guide* (July 1997); GAO's *Assessing Risks and Returns: A Guide for Evaluating Federal Agencies' IT Investment Decision-making* (Feb. 1997); and other federal guidance.

amounts, the following should be disclosed in the financial statements regarding the software:

- The cost, associated amortization, and book value.
- The estimated useful life for each major class of software.
- The method(s) of amortization.

Implementation

36. Cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred. However, the provisions of this statement concerning amortization and impairment should be applied to any unamortized cost capitalized prior to the initial application of this statement that continue to be reported as assets after the effective date.

Appendix A: Basis For Conclusions

General Property, Plant, And Equipment

37. As stated in Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 10, the Federal Accounting Standards Advisory Board (Board) believes that measuring the cost associated with using general property, plant, and equipment (PP&E), and including that cost in a federal entity's operating results will help to achieve the operating performance objective. To meet the operating performance objective, the Board seeks to provide accounting standards that will result in
- relevant and reliable cost information for decision-making by internal users,
 - comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
 - information to help assess the efficiency and effectiveness of asset management.
38. The Board believes that the cost of software acquired or developed for internal use that meets the SFFAS No. 6 criterion for general PP&E should be capitalized. Internal use software is specifically identifiable, can have determinate lives of 2 years or more, is not intended for sale in the ordinary course of operations, and has been acquired or constructed with the intention of being used by the entity.¹⁰
39. This standard does not apply to software that is an integral part of stewardship property, plant, and equipment. For example, if software is a part of a weapons systems, it would not be capitalized but included in the cost of investing in that weapons system. On the other hand, software used to accumulate the cost of acquiring that weapons system or to manage and account for that item would meet the criteria for general PP&E and should be capitalized.
40. Regarding any costs of internal use software acquired or developed for stewardship PP&E or stewardship investments, the Board chose to

¹⁰See SFFAS No. 6, par. 17.

follow SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and SFFAS No. 8, *Supplementary Stewardship Reporting*, and expense them as incurred. For example, a research project may involve new software applications for computer simulation or modeling and meet the definition of a stewardship investment in research and development. In such cases, that software should be expensed as part of that research and development stewardship investment. However, software used to manage, account for, and report on research and development projects and activities would meet the criteria for general PP&E and should be capitalized.

Comparison With SFFAS No. 6

41. As explained in the following paragraphs and in subsequent sections of the Basis for Conclusions, the accounting standard for internal use software required some tailoring of the provisions in SFFAS No. 6. First, the criteria in this standard for determining when to start amortizing/depreciating differs from SFFAS No. 6. SFFAS No. 6 provides that for constructed PP&E, depreciation begins when the PP&E is “placed in service.” However, this standard defines the start of amortization for internal use software as the point when final acceptance testing is successfully completed. This additional criteria is necessary, especially for internally developed software—but also for contractor-developed and commercial off-the-shelf (COTS) software—because (1) testing plays a major role for software assets by demonstrating that the software product can meet the requirements and (2) of the need for clear point for ending the developmental phase.
42. A second area of tailoring involves “enhancements” and other potentially capitalizable expenditures incurred after the software and/or other general PP&E is in service. SFFAS No. 6 provides a criterion for capitalizable cost for general PP&E that is different from that required here for software enhancements. SFFAS No. 6 provides that cost incurred to either extend the useful life of existing general PP&E or to enlarge or improve its capacity should be capitalized.¹¹
43. By contrast, this standard, as explained below, takes a different tack for software. It provides that material expenditures to add capability/functionality would be capitalized but expenditures that result in extending useful life or capacity would be expensed.

¹¹Par. 37.

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44. Finally, it should be noted that this standard provides additional procedures for recognizing and measuring impairment. The provisions in this standard and in SFFAS No. 6 are the same regarding situations where the software/general PP&E is impaired and will be removed from service in its entirety. Both provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, as explained below, this standard also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

-
- Respondent's Comments**
45. The respondents to the exposure draft (ED), *Accounting for Internal Use Software*, generally agreed with the principles presented therein. Most of the respondents agreed that the cost of internal use software and enhancements thereto should be capitalized, that capitalized amounts should be written down or off when the software is impaired, and that the guidance in the ED was sufficient to identify capitalizable cost and to recognize impairment. Two-thirds of the respondents agreed with the capitalization point in the ED—after (1) management authorizes and commits to funding a project and believes that it is more likely than not that the project will be successful and (2) the preliminary design stage is complete.
46. Some respondents raised objections and concerns, similar to those expressed in response to the original PP&E exposure draft, about capitalizing software, especially internally developed software. They were concerned that distinguishing between the cost of new and/or enhanced software on the one hand and maintenance and routine improvements that do not benefit future periods on the other hand would be difficult. Other respondents noted the rapidity with which technology changes and current software becomes obsolete, and said that the risky and uncertain nature of software development makes write-off much more likely for software than for general PP&E.
47. Notwithstanding these objections, the Board continues to believe that internal use software is similar to other general PP&E and should be accounted for accordingly. Internal use software and other **information technology** products and services are important resources for government operations. They are subject to similar risks of impairment and write-off and, otherwise, have general PP&E characteristics. Moreover, some respondents said they were already

capitalizing their COTS software, which represents a large and growing percentage of their software portfolio.

48. The Board believes that the difference between internal use software and other general PP&E is not sufficient to justify different accounting treatment. This standard provides guidance for determining when capitalization starts and stops, how to amortize the software, how to determine and measure impairment, and other guidance.

Cost-Benefit

49. Several of the respondents opposed the capitalization of internal use software because they do not believe that the benefits of doing so are worth the cost. The respondents are concerned about the difficulty and cost of evaluating, measuring, and tracking such information. Some respondents point especially to the difficulty of allocating federal employees' salaries and contractors' cost in multiuse contracts (e.g., systems development and maintenance).
50. Some argue (1) that capitalized internal cost related to developing internal use software is often unrelated to the software's actual value or is irrelevant, (2) that capitalization would result in arbitrary values and amortization periods, and (3) that such cost is frequently written-off, causing readers to be misled by the initial capitalization and subsequent write-off.
51. In Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, the Board points out that recommending accounting standards necessarily involves judgments about the cost and benefits of producing information and that standards can have different effects on different users. The Board is concerned that the benefits from standards should exceed the cost of complying with them but realizes that the benefits from standards are very hard to quantify.¹²
52. The Board is persuaded that the benefits from this standard exceed the cost. The Board believes that internal use software meets the

¹²Also, see OMB Circular A-130, *Management of Federal Information Resources*, par. 7d, which establishes the goal of having benefits exceed cost but notes that "the benefits to be derived from government information may not always be quantifiable."

definition of general PP&E and that general PP&E ought to be capitalized as an asset and amortized to the future periods benefited.

53. Capitalizing software contributes to the effective management of federal entities' resources. The careful measurement of the cost to construct capital assets, the matching of such cost to periods and programs benefitted on the federal entity's statement of net cost, and the comparison of cost with other alternatives for achieving the entity's goal comprise good management. Moreover, the regular review of software assets for impairment provides an early warning of problems. In short, such information provides periodic feedback about the quality and competitiveness of software products and services.¹³
54. The Board believes that expensing software costs incurred (1) in the preliminary design stage, (2) for software repairs and improvements that increase efficiency and useful life (see discussion of enhancements below), and (3) under materiality considerations will ease the burden of complying with this standard. Federal entities incur cost in the preliminary design stage exploring design and technical possibilities. Expensing this cost will limit the risk of "over-capitalization."
55. The Board realizes that software—in general—and internally developed internal use software—in particular—present difficult materiality considerations. However, the Board believes that federal entities will be able to use their discretion under the materiality provisions of federal accounting standards to set reasonable limits to capitalization and avoid incurring excessive cost in tracking de minimis items.
56. SFFAS No. 4 calls for the full cost of resources that directly and indirectly contribute to the production of outputs to be assigned to outputs through appropriate costing methodologies. Cost effectiveness is a key consideration in selecting a cost assignment method. As a general rule, directly tracing costs and assigning costs on a cause-and-effect basis are more expensive than cost allocations, because they require detailed analyses and record-keeping for costs

¹³See OMB Circular A-130, par. 8a, "Information Management Policy," and par. 9b, as well as OMB's *Capital Programming Guide*, for detailed guidance on analyzing information technology through the planning, acquisition, and management-in-use phases.

and activities. However, they are preferable because they produce more reliable cost information than cost allocations.¹⁴ In any case, the method used to trace, assign or allocate costs must produce materially correct and complete costs.

57. The Board acknowledges that the service life of software is less predictable than that for other general PP&E. However, the Board is not persuaded that the difficulties of estimation and adjustment justify an accounting treatment different from that for other general PP&E. The Board believes that the additional guidance in the standard versus that in the ED will address the concerns raised by respondents and will be sufficient for federal entities to comply with the standard.

**Cost To Be Capitalized—
Direct And Indirect Cost**

58. Many respondents agreed with the ED position that indirect cost should be expensed. The ED provided that such cost should be expensed because of cost-benefit considerations and the risk of over-capitalization.
59. Several respondents objected to the failure of the ED to require indirect as well as direct costs to be capitalized. Most of these respondents based their objection on the full-cost requirements in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, believing that the Board would not be consistent with this standard unless full cost accounting were adopted.
60. The Board had reserved final judgment on the issue of capitalizing indirect cost at the time the ED was published. Several of the Board's members had argued that capitalizing only direct cost was inconsistent with SFFAS No. 4. Also, some Board members felt that, if the standard not did require indirect cost to be capitalized, the cost of internally developed internal use software would not be comparable with COTS and contractor-developed software, which would include indirect cost.
61. After reconsidering the issue, the Board is persuaded that SFFAS No. 4 requires both direct and indirect costs to be capitalized. Moreover, the

¹⁴SFFAS No. 4, par. 143.

new federal capital programming guidelines¹⁵ require full life-cycle cost to be tracked, which is a more extensive requirement than that required by this standard, since it includes cost that would be expensed for accounting purposes.¹⁶ Also, software asset values will be comparable among internally developed, COTS and contractor-developed software.

Commencing Capitalization

62. Two-thirds of the respondents agreed that capitalization should begin as described in par. 21 of the ED (and par. 16 of this standard): that is, when (1) management authorizes and commits to a software project and believes that it is more likely than not that the software will be completed and (2) the preliminary design stage is complete. Two of these respondents noted that the standard was consistent in this regard with the American Institute of Certified Public Accountant's (AICPA) draft Statement of Position (SOP).¹⁷ Six other respondents would begin to capitalize only when "technological feasibility" is demonstrated.¹⁸ Other respondents either would not capitalize internal use software under any circumstances or only COTS software.
63. The Board has added a framework for identifying the stages of a software project. Also, the standard now draws a sharper distinction between internally developed software on the one hand and COTS and contractor-developed software on the other. However, the Board believes that flexibility is needed so that the standard can be applied governmentwide.

¹⁵The Office of Management and Budget's (OMB) *Capital Programming Guide*, Supplement to OMB Circular A-11, Part 3 (July 1997), integrates the various executive branch and statutory asset management initiatives, including the Government Performance and Results Act, the Clinger-Cohen Act, and the Federal Acquisition Streamlining Act, into a single, integrated capital-programming guide.

¹⁶"Capital assets are land, structures, equipment, and intellectual property (including software) that ... have an estimated life of two years or more... The cost of a capital asset is its full life-cycle cost, including all direct and indirect cost for planning, procurement ... operations and maintenance, including service contracts and disposal." *Capital Programming Guide*, version 1.0, definition of capital asset, p. i (July 1997).

¹⁷Published March 4, 1998 as SOP No. 98-1.

¹⁸"Technological feasibility" is the criteria that the Financial Accounting Standards Board (FASB) used in Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*.

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64. One respondent asked for clarification regarding management's commitment to the software project. This is critical, since it is the starting point for the capitalization of software cost. The Board believes that management's authorization and commitment are a recognizable point for major software projects. A "go/no go" decision should be a visible milestone. Management should use its best judgment to identify when its commitment to a major software project takes place.
65. The Board decided that the "technological feasibility" test in SFFAS No. 6, which follows the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 86, should be changed. The Board believes that that test is appropriate for software developed for sale or lease or otherwise marketed but is not applicable to internal use software. Federal software should be capitalized because it is a long-lived operating asset rather than inventory to be sold. However, federal entities normally do not develop software for sale. If, in a rare instance, an entity should engage to develop software for another federal entity, SFAS No. 86 would be applicable.

Software Licenses

66. One respondent asked for guidance on accounting for licenses for COTS software. The Board had not discussed software licenses during its deliberations leading up to the publication of the ED. Software licenses can cover periods ranging from the entire estimated service life of the software (a "perpetual" license) to annual or more frequent periods and are similar to leases of general PP&E.
67. The Board believes that it would be appropriate for the federal entity to apply lease accounting concepts¹⁹ and the entity's existing policy for capitalization thresholds and for bulk purchases to licenses. Immaterial costs would be expensed, but the entity should consider whether period costs would be distorted by expensing the license.

Capitalization Thresholds

68. In SFFAS No. 6, the Board carefully considered whether to take a prescriptive approach regarding capitalization thresholds or to permit each entity to set its threshold in light of its own particular operating

¹⁹See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, "Capital Leases," pars. 43-46, and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, par. 20, for federal accounting standards for leases.

environment. The Board decided that federal entities were too diverse to require one threshold for all entities; hence, the Board adopted a materiality approach whereby each entity establishes its own threshold as well as the guidance for bulk purchases. The Board continues to believe that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

Data Conversion Cost

69. The issue of whether to capitalize all, some, or no data conversion cost is a difficult one. Some argue that the cost of converting existing data to a new software system is analogous to the types of cost that the Accounting Principles Board Opinion (APB) No. 17, *Intangible Assets*, requires to be expensed as incurred because they are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole—such as goodwill (APB 17, par. 24). The Board is persuaded that data conversion costs are operating costs and should be expensed.

Amortization Period

70. Most respondents said that no maximum period for amortization should be set in the standard. One respondent asked for clarification regarding the meaning of the general requirement that the amortization period be “consistent with management’s plan for use.” Another respondent asked whether the amortization period should begin when capitalization stops or when the system is put into use, saying that, often, there can be a significant time lag between these two events. One respondent asked for clarification regarding incremental implementation.
71. The Board has added additional guidance regarding the cessation of capitalization and commencement of amortization. The standard now focuses on the point when testing is complete. The term “operational,” which some respondents found vague, is no longer used as a definitive point for cessation of capitalization. Also, provision has been made to treat each location and/or module separately.

Enhancements

72. Several respondents requested additional guidance for distinguishing maintenance from enhancements. The exposure draft proposed capitalizing the cost of changes to the existing system as an enhancement if it is more likely than not that the changes add capabilities or useful life. One respondent asked whether the cost of changes that make the software or system easier to use and users

more efficient, but do not significantly change the capability/functionality (i.e., the system does not do any additional tasks), should be expensed or capitalized. Also, the ED proposed that year 2000 (Y2K) cost be expensed as incurred, even though they extend useful life. Several respondents asked whether Y2K cost were “enhancements.”

73. The Board believes that an “enhancement” should be limited to instances where significant new capabilities are being added to the software. Merely making the software more efficient and/or extending its service life should not constitute a capitalizable cost. Software is more fluid and malleable than other PP&E and the Board concludes that a higher threshold for additional capitalization is reasonable.

Impairment

74. Two-thirds of the respondents said that the guidance on impairment was sufficient. Several respondents had questions about how the impairment provisions would apply to particular situations.

75. A respondent asked whether the availability of a new, updated version of COTS software with significantly improved functionality, efficiency, or effectiveness means that the older version is impaired even if the older version is still performing the functions for which it was designed. He asked whether the availability of new technology, whether adapted or not, render existing software “impaired.” He asked about the affect of modernizing existing software to take advantage of the new technology. This respondent was concerned that if modernization is included in the definition of “impairment,” there will be constant write-downs.

76. The Board believes that none of the situations cited by the respondent would meet the criteria of this standard in paragraphs 28-31. According to the criteria, in order for software to be considered impaired, it would have to have lost its service potential such that the federal entity would plan to remove it from service or the software would have had its capabilities reduced.

77. One respondent asked about the ED’s proposal for expensing Y2K cost. Since the implementation date for this standard has been moved back to FY 2001, the issue is largely moot. However, the Board’s rationale for recommending that the Y2K cost be expensed is that such cost is incurred to repair a design flaw rather than to add to the

software's capabilities or useful life, although the latter would be affected.

Working Capital Funds

78. At least one respondent was concerned about the impact of capitalizing non-COTS internal use software on the cash flows, billing rates, and performance measurement of working capital funds (WCFs). This respondent said that developing software internally and through contractors could require long lead times during which WCFs would have to finance the project because WCFs could not start to recover the cost from customers until the software project was complete and amortization commences. Also, this respondent said that write-downs or write-offs due to impairment by rapidly changing technology would be difficult to recapture from customers who expect and budget for consistent billing rates. This respondent believes that the capitalization of internally developed or contractor-developed software could result in fluctuating rates depending on when new projects come "on line" and on write-downs or write-offs due to impairment.
79. This respondent said that if write-downs or write-offs cannot be recovered from customers, then capital funds would be unavailable for investment, the WCFs' equity could be seriously impaired, and the WCFs would rapidly become unable to effectively provide the services for which they were established. The respondent said that WCFs are vulnerable to capital shortages because they operate on a break-even basis rather than generate retained earnings, and because they do not have access to private capital markets. This respondent's WCF currently capitalizes COTS software because it is a proven commodity; it becomes operational immediately and the WCF can begin chargingback the cost to customers.
80. Fixed assets usually provide important future benefits but require large amounts of resources up-front and extended periods for planning and acquisition. Making capital planning decisions is often difficult for agencies because full budget authority is required before the acquisition can commence and the entire acquisition has an immediate budgetary impact. This makes capital assets look expensive relative

to, for example, annual lease payments even though the latter may be more expensive in the longrun.²⁰

81. Notwithstanding these very real concerns, the Board concludes that the WCFs problem is one of budgetary control and program finance rather than of accounting. Congress has instituted various alternatives for WCFs to acquire capital. The Board's responsibility is to recommend what it considers the best accounting treatment considering all the circumstances and the Board's objectives.

Implementation Date

82. The 23 respondents who addressed the question of the implementation date were almost evenly divided as to the feasibility of an FY 1999 implementation date. Most respondents opposing the FY 1999 date said that federal agencies do not have the cost accounting systems as yet to account for capitalized cost but are developing such capabilities. Some respondents said that most federal agencies have a great deal "on their plate" now, when one considers the many recent initiatives. They said that an FY 2000 or FY 2001 implementation date would be better.

83. One respondent said that the AICPA's SOP is effective for periods beginning after December 15, 1998, and that there is no reason for the federal government to adapt such a standard before the private sector does. The respondent said that federal implementation after the private sector implements its standard would allow the federal government to learn from the private sector's experience.

84. The Board believes that federal entities are striving to meet deadlines for audited financial statements, performance reports, cost accounting, technology management, and other initiatives. Entities resources are under stress to meet these deadlines. Thus, the Board believes that moving the implementation to FY 2001 is reasonable.

²⁰See GAO, *Budget Issues: Budgeting for Federal Capital* (GAO/AIMD-97-5 Nov. 1996), for (1) an analysis of capital budgeting problems experienced by WCFs and federal agencies generally and (2) possible solutions.

**Appendix B:
Glossary**

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Statement of Federal Financial Accounting Standards 11:
Amendments to Accounting for Property, Plant, and Equipment -
Definitional Changes - Amending SFFAS 6 and SFFAS 8
Accounting for Property, Plant, and Equipment and
Supplementary Stewardship Reporting

Status

Issued	December 15, 1998
Effective Date	The amendments to SFFAS 6 and 8 in this statement were effective for periods beginning after September 30, 1998, until September 30, 2002, when this statement was rescinded in its entirety by SFFAS 23.
Volume II References	None.
Interpretations and Technical Releases	None.
Affects	None.
Affected by	• SFFAS 23 rescinds SFFAS 11 in its entirety.

Statement of Federal Financial Accounting Standards 12: Recognition of Contingent Liabilities Arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government

Status

Issued	December 1998
Effective Date	For periods beginning after September 30, 1997
Volume II References	Liabilities (L40)
Interpretations and Technical Releases	None.
Affects	SFFAS 5, paragraphs 33 and 36, by changing the recognition criteria for recognizing liabilities arising from litigation.
Affected by	None.

Summary

This standard amends Statement of Federal Financial Accounting Standards 5, Accounting for Liabilities of the Federal Government (SFFAS 5). It provides an exception to the contingent liability standard for recognizing loss contingencies on matters of pending or threatened litigation and unasserted claims.

For loss contingencies for matters of pending or threatened litigation and unasserted claims, a contingent liability would be recognized¹ when a future outflow or other sacrifice of resources is “likely to occur,” a past event or exchange transaction has occurred, and the future outflow or sacrifice of resources is measurable. Before the amendment, SFFAS 5 called for recognition when an outflow is “more likely than not.” In addition to recognition, disclosure² would be required for loss contingencies on matters of pending or threatened litigation and unasserted claims if it is at least reasonably possible that a loss or an additional loss may have been incurred. The amendment does not affect recognition of other types of contingencies.

¹The term “recognize” means the formal recording or incorporating of an item into the financial statements of an entity as an asset, liability, revenue, expense, etc. See FASAB Consolidated Glossary

²The term “disclosure” means the reporting of information in notes or narrative regarded as an integral part of the basic financial statement. See FASAB Consolidated Glossary.

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Purpose

1. This Statement amends Statement of Federal Financial Accounting Standards Number 5 (SFFAS No. 5), *Accounting for Liabilities of the Federal Government*, to provide an exception to the contingent liability standard for matters of pending or threatened litigation and unasserted claims. The proposed amendment would affect accounting for contingencies under SFFAS No. 5 by inserting an exception to the definition of “probable” and to the recognition criteria in SFFAS No. 5 (see current paragraphs 33, 36, and 38 of that standard in Appendix C).

Scope

2. This standard applies to evaluations and accounting recognition and disclosure of the future outcome of litigation.

Background

3. The Federal Accounting Standards Advisory Board (FASAB) was asked to clarify the application of the standard for recognizing loss contingencies for pending or threatened litigation and unasserted claims. SFFAS No. 5 provides the definition for “liability” and establishes specific standards for five liability categories, including contingencies.
4. SFFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss.³ SFFAS No. 5 requires a liability to be recognized for loss contingencies when a past event or exchange transaction makes a future outflow of resources probable and measurable.⁴ It defines “probable” as that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.⁵
5. SFFAS No. 5 uses the same general framework for evaluating loss contingencies as Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (SFAS No. 5). Contingencies can be “probable,”

³SFFAS No. 5, par. 35, and also in Appendix C.

⁴SFFAS No.5, par. 36.

⁵SFFAS No. 5, par. 33 and also see SFFAS No. 5’s Glossary.

“reasonably possible,” or “remote,” and, based on that, are recognized on the balance sheet, disclosed in footnotes, or not mentioned in the financial statements, respectively. However, SFAS No. 5 defines “probable” as “likely to occur” instead of “more likely than not.”⁶

6. Some auditors have expressed reservations about their ability under Statement of Auditing Standards 12 (SAS 12) to express an unqualified opinion on the entity’s financial statements without a legal representation letter that refers to the SFFAS No. 5 standard. Lawyers have expressed serious objection to the definition of probable (“more likely than not”) contained in SFFAS No. 5. They state that a lawyer’s prediction of failure under the SFFAS No. 5 definition of “probable” (“more likely than not”), and the recording of a liability to reflect that judgment, could be used as an admission against interest, thereby jeopardizing the government’s ability to fairly defend the public interest. Similarly, they further state that a lawyer’s response to an auditor’s request for information on matters where an unfavorable outcome is more likely than not could result in the disclosure of information protected by the lawyer-client privilege, disadvantaging the government in any dispute, and violating the American Bar Association’s Code of Professional Responsibility.
7. The Board believes that this amendment clarifies the standard for contingencies involving pending or threatened litigation and unasserted claims and will facilitate communication among auditors, lawyers, those who prepare financial statements, and those who use the financial statements.

Materiality

8. The provisions of this statement need not be applied to immaterial items.

Effective Date

9. This standard is effective for reports issued subsequent to the date of this statement for reporting periods beginning after September 30, 1997.

⁶SFFAS No. 5, par. 3.

Accounting Standard

10. Paragraph 33 of SFFAS No. 5 is amended by adding “with the exception of pending or threatened litigation and unasserted claims” at the end of the first sentence. Paragraph 33 is further amended by adding the following footnote to the first sentence:

The concept of probability is imprecise and difficult to apply with respect to most legal matters. The “more likely than not” phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation. Accordingly, in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability, “probable” refers to that which is likely, not to that which is more likely than not. Note that the remaining two criteria for recognizing a liability—that is, a past event or exchange transaction has occurred and the future outflow or sacrifice of resources is measurable—also must be met before recognizing a contingent liability in matters involving litigation.

11. Other conforming changes to SFFAS No. 5 are:

The first bullet of paragraph 36 is changed as follows: “Probable: The future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.”

Paragraph 38 of SFFAS No. 5 is amended by replacing “more likely than not” in the second bullet with “likely.”

Appendix A: Basis for Conclusions

12. In their capacity as legal counsel to federal agencies, lawyers should evaluate the outcome of matters of pending or threatened litigation and unasserted claims, and estimate any losses therefrom, in accordance with the American Bar Association's *Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information*. Attorneys note that neither the outcome of litigation nor any loss resulting therefrom can be assessed "in any way that is comparable to a statistically or empirically determined concept of probability" (see *Auditor's Letter Handbook*, American Bar Association, page 18). The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation.
13. Accordingly, in the context of such cases the standard refers simply to that which is "likely." In this context, therefore, "likely to occur" is used in federal accounting standards in the same way that it is used in Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, published by the Financial Accounting Standards Board in 1975.
14. The Board believes that this amendment will serve the objectives of financial reporting because it will facilitate communications among auditors, lawyers, those who prepare financial statements, and those who use the statements.
15. The Board published an exposure draft of this standard on October 30, 1998, and received thirty responses, six of which had no comment. Of the 24 who commented, 22 concurred with the proposed standard. (Two responses were positive but could not be characterized as concurrence.) No respondent objected to the amendment. Five respondents suggested broadening the scope of the amendment to apply "likely to occur" to all contingent liabilities.
16. Although some respondents suggested broadening the application, the Board concluded that the amendment should be limited to contingent liabilities resulting from litigation. Most respondents concurred with this approach. The Board plans additional research on this subject in 1999.
17. The Board has made minor changes to the proposal published as an exposure draft. Several respondents suggested minor changes in

wording and/or notations in paragraphs 33 and 36 in addition to or instead of paragraph 38 to clarify the amendment. The Board has adopted most of these suggestions.

18. The Board makes this recommendation with a vote of nine members approving issuance and no members opposing issuance.

**Appendix B:
Selected Section
from Statement of
Financial
Accounting
Standards No. 5,
Accounting for
Contingencies.**

1. For the purposes of this Statement, a contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a “gain contingency”) or loss (hereinafter a “loss contingency”) to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability.

* * *

3. When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms *probable*, *reasonably possible*, and *remote* to identify three areas within that range, as follows:

- a. *Probable*. The future event or events are likely to occur.
- b. *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
- c. *Remote*. The chance of the future event or events occurring is slight.

* * *

8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:
 - a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statement. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
 - b. The amount of the loss can be reasonably estimated.

**Appendix C:
Selected Sections of
Statement of
Federal Financial
Accounting
Standards No. 5,
Accounting for
Liabilities of the
Federal
Government
(footnotes omitted).**

33. “Probable” refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.

Contingencies

35. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).
36. This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incidence of a liability can range from probable to remote. The probability classifications are as follows:
- Probable: The future confirming event or events are more likely than not to occur.
 - Reasonably possible: The chances of the future confirming event or events occurring is more than remote but less than probable.
 - Remote: The chance of the future event or events occurring is slight.

37. The following are some examples of loss contingencies:

- collectibility of receivables,
- pending or threatened litigation, and
- possible claims and assessments.

Criteria For Recognition Of A Contingent Liability

38. A contingent liability should be recognized when all of these three conditions are met:

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).
- A future outflow or other sacrifice of resources is probable (e.g., the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is more likely than not to be settled in favor of the claimant).
- The future outflow of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount).

39. The estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed.

Criteria For Disclosure Of A Contingent Liability

40. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. "Disclosure" in this context refers to reporting information in notes regarded as an integral part of the basic financial information.

41. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

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42. In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose federal financial reports. Specifically, contingencies classified as remote need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.

Statement of Federal Financial Accounting Standards 13: Deferral of Paragraph 65.2—Material Revenue-Related Transactions Disclosures

Status

Issued	January 1999
Effective Date	This amendment was effective for fiscal periods beginning after September 30, 1998, until October 1, 2000, when paragraph 65.2 of SFFAS 7 was rescinded by SFFAS 20.
Volume II References	Revenue (R40)
Interpretations and Technical Releases	None.
Affects	SFFAS 7 by deferring the effective date of disclosure requirements in Paragraph 65.2.
Affected by	SFFAS 20 rescinded SFFAS 7, paragraph 65.2.

Summary

This statement deferred paragraph 65.2 of SFFAS 7 for three years. As a result, paragraph 65.2 would have become effective for periods beginning after September 30, 2000; however, paragraph 65.2 was subsequently rescinded by SFFAS 20.

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Background

1. Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources* including paragraphs 65.2 became effective for fiscal year 1998. It included detailed provisions that apply to entities collecting taxes on behalf of the Federal Government.

2. Paragraph 65.2 of SFFAS No. 7 states:

Entities that collect taxes and duties should disclose:
65.2 **Material revenue related transactions.** Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by the taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.

3. Because of difficulties in preparing the information and questions as to its usefulness, the Board agreed to consider deletion of paragraph 65.2. Ultimately, the Board agreed that more study of the issues was needed. Accordingly, it agreed that the requirement should be deferred.

Statement of Standards

4. Paragraph 65.2 of SFFAS No. 7 is deferred three years; it will be effective for periods beginning after September 30, 2000.

Effective Date

5. This amendment is effective for fiscal periods beginning after September 30, 1998. Earlier implementation is encouraged.

Basis for Conclusions

6. Experience gained by IRS and GAO while attempting to implement the provisions of SFFAS No. 7 provided greater insight into the difficulties of preparing, analyzing, and communicating the information described in paragraph 65.2 than was available when SFFAS No. 7 was approved. Based on that additional experience and insight, the Board proposed that subparagraph 65.2 should be rescinded. An exposure draft to accomplish this was published in November 1998. The exposure draft included the alternative view of one Board member. He believed that subparagraph 65.2 should be retained, albeit possibly with some modification.
7. The responses received by the Board which expressed an opinion on the proposal were approximately evenly divided. Respondents supporting the deletion indicated that the requirements were calling for more detailed analysis than generally found in accounting standards, were not cost beneficial, and were potentially misleading because assessments and associated abatements are often substantially overstated. Respondents opposing the deletion indicated that the requirements were essential for proper management and oversight, necessary to overcome the limitations of the modified cash basis of accounting for tax revenues, and helpful in ensuring that systems support evaluations of activity during the year.
8. After reviewing the comment letters and redeliberating, the Board agreed that the primary question was the degree to which the information would be relevant. Some members believe the information would be relevant to users and that it, or similar information, is needed to address the objectives of federal financial reporting. Other members believe that the information presented by IRS and the GAO staff responsible for auditing the financial statements of IRS calls into question the Board's prior conclusion that the information is relevant. Responses to the exposure draft that proposed deletion of subparagraph 65.2 did not resolve this issue. Therefore, the Board agreed that it should conduct further study regarding the relevance of the items of information discussed in subparagraph 65.2.
9. The Board concluded that the effective date for subparagraph 65.2 should be deferred three years; from fiscal year 1998 to fiscal year 2001. The Board expects to complete the study before the new effective date.

Board Approval

10. The Board approves this recommendation by a vote of eight members approving its issuance and one member opposing its issuance.

Statement of Federal Financial Accounting Standards 14: Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting

Status

Issued	April 1999
Effective Date	For fiscal years beginning after September 30, 1998 with earlier implementation encouraged.
Volume II References	Deferred Maintenance (D20)
Interpretations and Technical Releases	
Affects	<ul style="list-style-type: none">• SFFAS 6, paragraphs 79-80, and 83-84 by changing certain section headings and adding phrases to paragraphs 83-84.
Affected by	<ul style="list-style-type: none">• SFFAS 29, par. 13 rescinds par. 10 and 11 of SFFAS 14.

Summary

Deferred maintenance reporting is a required disclosure per Statement of Federal Financial Accounting Standards 6, *Accounting for Property, Plant, and Equipment* (SFFAS 6), and is referenced in SFFAS 8, *Supplementary Stewardship Reporting*. This amendment does not modify the information to be provided users of federal financial statements. It does, however, modify the status of that information and thus the level of its review by financial statement auditors.

When SFFAS 6 was issued, the Board indicated that deferred maintenance reporting would evolve as preparers gained experience. The Board provided maximum flexibility to preparers noting that management would determine “acceptable condition” against which deferred maintenance would be assessed. (see SFFAS 6, par. 78, footnote 58) In addition, the Board noted that acceptable condition might vary between entities **and** between sites within the same entity. To ensure that readers would understand the deferred maintenance disclosures, the Board required that management’s method of measuring deferred maintenance and management’s requirements for acceptable condition be disclosed with the estimated amounts.

After the statement became effective, questions arose about whether this flexibility was appropriate given the status of the information as basic information (i.e., an integral part of the financial statements). The Board agreed that a change in status was warranted.

This statement amends SFFAS 6 and SFFAS 8 to define deferred maintenance information as required supplemental information (RSI) rather than within the financial statements and the notes thereto.

As required supplementary information, the deferred maintenance information will be subject to the audit procedures prescribed in AU Section 558.07, *Codification of Statements on Auditing Standards*. These procedures include inquiries to management and comparisons of the information for consistency. In addition, the auditor should consider whether the RSI should be covered in management’s representation letter. The auditor may need to apply additional procedures required by other guidance, and to make additional inquiries

if necessary based on the outcome of the required procedures. Readers should refer to the most current auditing standards for relevant guidance.

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Introduction

Purpose	<ol style="list-style-type: none"> 1. The purpose of this amendment is to change the status of deferred maintenance information required by Statement of Federal Financial Accounting Standard No. 6, <i>Accounting for Property, Plant, and Equipment</i>. Before amendment, this information would have been presented in association with the statement of net costs. As amended, the standards require that deferred maintenance information be included as required supplemental information (RSI). Thus, a line item for “deferred maintenance” would no longer be required on the statement of net costs with a reference to a note disclosure. 2. The Basis for Conclusions presents the reasons for these amendments.
Scope	<ol style="list-style-type: none"> 3. The statement amends both SFFAS 6 and 8 with regard to information on deferred maintenance.
Effective Date	<ol style="list-style-type: none"> 4. This amendment is effective for periods beginning after September 30, 1998 with earlier implementation encouraged.

Accounting Standards

Amendments to SFFAS No. 6	<ol style="list-style-type: none"> 5. Paragraph 79 and the heading “RECOGNITION” that precedes it are deleted. 6. The section heading “DISCLOSURE REQUIREMENTS” which appears before paragraph 80 is deleted. Paragraph 80 is amended by replacing “disclosed” with “reported.” 7. The section heading “Disclosures” before paragraph 83 is replaced with “Required Supplementary Information.”
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8. Paragraph 83 is amended by adding the phrase “as required supplementary information” between the phrases “shall be presented” and “for all PP&E.” The requirement to report a range estimate when using the condition assessment survey method is modified by inserting “or a point” after the words “and a range.”
 9. The section heading “Optional Disclosures” before paragraph 84 is replaced with “Optional Information.” In the second sentence, the word “disclose” is replaced with “report” and the word “disclosure” is replaced with “information.”

...[Paragraph 10 & 11 were rescinded by SFFAS 29 par. 13]

Appendix A: Basis for Conclusions

12. The Board believes that the experience gained in implementing SFFAS Nos. 6 and 8 provides greater insight into the required deferred maintenance disclosures. In recommending the deferred maintenance standards, the Board recognized that experimentation would be needed before high quality information on deferred maintenance was available throughout the federal government. However, the implementation experience brought to light concerns regarding the degree of flexibility afforded during the experimentation period and audit issues.
13. In December 1998, the Board issued an exposure draft proposing amendments intended to address the concerns being raised. The concerns included:
 - a. the ability of preparers to disclose an extremely large range estimate; and
 - b. users perceptions regarding the nature of the information¹ being presented.
14. The exposure draft proposed that deferred maintenance information be moved from being associated with the Statement of Net Cost to Required Supplementary Stewardship Information (RSSI). The Board believed that this was consistent with the importance of the information as well as the experimental nature of the information. The Board explained in the exposure draft that the information would be audited as if it were required supplemental information (RSI).

¹While deferred maintenance information as required under the SFFAS 6 provisions is very relevant, implementation demonstrated that it may not be reliable or comparable. The Board is concerned that placement of this information in notes would be a disservice to users.

15. There were 20 respondents to the exposure draft. The respondents were from the following groups:

	Federal	Nonfederal	Total
Users and others		2	2
Preparers	9		9
Auditors	9		9
Total	18	2	20

16. One respondent opposed the proposal and stated a preference for a delayed effective date. Seventeen respondents supported the proposal and two did not directly indicate support or opposition.
17. Respondents noted the need for more detailed guidance on preparing estimates as well as specific issues such as overseas facilities which have differing facilities standards. One respondent suggested that guidance be developed for small agencies for which deferred maintenance reporting may be unnecessarily burdensome. Many respondents acknowledged the importance of the disclosures and the need to address auditing standards for deferred maintenance as well as accounting standards.
18. A number of respondents suggested that moving deferred maintenance disclosures to stewardship reports would be appropriate because doing so would:
- a. lower the profile of the information,
 - b. prevent distortion of *financial* data,
 - c. reduce the resources needed to prepare and audit the data, and
 - d. resolve audit concerns.
19. The Board is concerned that stewardship reports—required for the first time for fiscal year 1998 reports—may be considered of lesser significance than “financial statements” and the associated notes. In fact, stewardship reports were intended to facilitate presentation of highly important financial and non-financial information about complex aspects of federal government operations and responsibilities. Thus the Board plans a review of the results of the

implementation of stewardship reporting requirements. That review is expected to take place during calendar year 1999.

20. The Board does not believe that adding deferred maintenance information to stewardship reports would be appropriate in light of the planned review. In addition, deferred maintenance information presents measurement issues not currently experienced in stewardship reports.
21. The Board believes that a period of experimentation is desirable for deferred maintenance information and that classifying it as RSI is appropriate during the experimentation period. The use of RSI for experimentation is consistent with the practices of other standard setting bodies. For example, the Financial Accounting Standards Board (FASB) conducted a five year experiment in reporting on changing prices through RSI. During the experimentation period, FASB permitted flexibility in measuring the effects of changing prices.
22. The Board believes that experimenting with deferred maintenance reporting is vitally important to improving its usefulness. The current standards for estimating deferred maintenance are intentionally flexible in the following ways:
 - a. either life cycle costing or condition assessment may serve as the basis for the estimates;
 - b. management determines the “acceptable condition” of PP&E and may vary the acceptable condition by site and type of property; and
 - c. engineering and/or maintenance standards are not referenced.
23. The Board intends that the Accounting and Auditing Policy Committee (AAPC) work with government-wide groups such as the Chief Financial Officers Council and the Presidents Council on Integrity and Efficiency to review the first year reports and identify areas requiring further guidance. At a minimum, the Board expects to develop guidance on determining acceptable condition. The Board plans to revise the standards based on experience gained during the experimentation period.

Board Approval

24. This recommended statement was approved by the Board with a vote of seven members in favor of its issuance and one member opposing its issuance. (Only eight members voted on this recommendation due to a vacancy on the Board.)

Appendix B: Amended Standards

Amendments To SFFAS 6

Definition

77. “Deferred maintenance” is maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period.
78. For purposes of this standard, maintenance is described as the act of keeping fixed assets in acceptable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life.⁵⁸ Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.
79. [See SFFAS 14 for the explanation of deletions.]^{59, 60}

Measurement

80. Amounts ... [reported] for deferred maintenance may be measured using:
- condition assessment surveys,
 - or life-cycle cost forecasts.⁶¹

⁵⁸[Acceptable services and condition may vary both between entities and among sites within the same entity. Management shall determine what level of service and condition is acceptable.]

⁵⁹[... See SFFAS 14]

⁶⁰[... See SFFAS 14]

⁶¹[Other methods may be used which are similar or identical to condition assessment survey or life-cycle costing. These methods would also be acceptable sources of information on deferred maintenance.]

81. *Condition assessment surveys* are periodic inspections of PP&E to determine their current condition and estimated cost to correct any deficiencies. It is desirable that condition assessment surveys be based on generally accepted methods and standards consistently applied.⁶²
82. *Life-cycle costing* is an acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets. Since it results in a forecast of maintenance expense, these forecasts may serve as a basis against which to compare actual maintenance expense and estimate deferred maintenance.

... [See SFFAS 14]

Required Supplementary Information

83. At a minimum, the following information shall be presented as required supplementary information for all PP&E (each of the four categories established in the PP&E standard should be included).
- Identification of each major class⁶³ of asset for which maintenance has been deferred.’
 - Method of measuring deferred maintenance for each major class of PP&E.
 - If the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E:
 - description of requirements or standards for acceptable operating condition,
 - any changes in the condition requirements or standards, and
 - **asset condition⁶⁴ and a range or a point estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition.**

⁶²[Management shall determine what methods and standards to apply. Once determined, it is desirable but not required that methods and standards be applied consistently from period to period.]

⁶³["Major classes" of general PP&E shall be determined by the entity. Examples of major class include, among others, buildings and structures, furniture and fixtures, equipment, vehicles, and land.]

⁶⁴[Examples of condition information include, among others, (1) averages of standardized condition rating codes, (2) percentage of assets above, at or below acceptable condition, or (3) narrative information.]

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- If the total life-cycle cost method is used the following should be presented for each major class of PP&E:
 - the original date of the maintenance forecast and an explanation for any changes to the forecast,
 - prior year balance of the cumulative deferred maintenance amount,
 - the dollar amount of maintenance that was defined by the professionals who designed, built or manage the PP&E as required maintenance for the reporting period,
 - the dollar amount of maintenance actually performed during the period,
 - the difference between the forecast and actual maintenance,
 - any adjustments to the scheduled amounts deemed necessary by the managers of the PP&E,⁶⁵ and
 - the ending cumulative balance for the reporting period for each major class of asset experiencing deferred maintenance.

Optional Information

84. Stratification between critical and noncritical amounts of maintenance needed to return each major class of asset to its acceptable operating condition. If management elects to report critical and noncritical amounts, the information shall include management's definition of these categories.

<p>The provisions of this statement need not be applied to immaterial items.</p>

⁶⁵[Adjustments may be necessary because the cost of maintenance foregone may not be cumulative. For example, if periodic painting is skipped twice it is not necessarily true that the cost would be double the scheduled amount.]

Statement of Federal Financial Accounting Standards 15: Management's Discussions and Analysis

Status

Issued	April 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Volume II References	Management's Discussion and Analysis (M10)
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

This document establishes standards for preparing Management's Discussion and Analysis (MD&A). MD&A is an important vehicle for (1) communicating managers' insights about the reporting entity, (2) increasing the understandability and usefulness of the general purpose federal financial report (GPFFR),¹ and (3) providing understandable and accessible information about the entity and its operations, service levels, successes, challenges, and future. Some federal agencies also refer to MD&A as the "overview."

The basic concept that underlies the standards for MD&A is:

Each general purpose federal financial report (GPFFR) should include a section devoted to management's discussion and analysis (MD&A). It should address the reporting entity's performance measures, financial statements, systems and controls, compliance with laws and regulations, and actions taken or planned to address problems. The discussion and analysis of these subjects may be based partly on information contained in reports other than the GPFFR. MD&A also should address significant events, conditions, trends and contingencies that may affect future operations.

A separate document titled *Concepts for Management's Discussion and Analysis* explains the conceptual basis for the role and importance of MD&A, the general content of the GPFFR, and the elements of MD&A. The concepts provide a foundation for the standards presented in this document. The concepts include suggestions about the contents of MD&A, but those suggestions are not accounting standards or principles for federal reporting entities. In particular, the concepts are not "prescribed guidelines" for required supplementary information as discussed in section 558 of the *Codification of Statements on Auditing*

¹The term "general purpose federal financial report," abbreviated GPFFR, is used as a generic term to refer to the report that contains the entity's financial statements that are prepared and audited pursuant to the CFO Act of 1990, as amended. Entities may refer to these reports using different terms, such as "Annual Report," "Accountability Report," "Financial Management Report," etc. Paragraphs 54-112 and Appendix 1 of Statement of Federal Financial Accounting Concepts 2, Entity and Display, describe and illustrate the contents of the GPFFR.

Standards published by the American Institute of Certified Public Accountants (AICPA). The only standards and prescribed guidelines for MD&A are in paragraphs 1-8 of this document.

The standards require MD&A to be included in each GPFFR as required supplementary information (RSI). MD&A should address:

- the entity's mission and organizational structure;
- the entity's performance goals and results;
- the entity's financial statements;
- the entity's systems, controls, and legal compliance; and
- the future effects on the entity of existing, currently-known demands, risks, uncertainties, events, conditions and trends.

The discussion and analysis of these subjects may be based on information in other discrete sections of the GPFFR or it may be based on reports separate from the GPFFR. The standards are effective for reporting periods that begin after September 30, 1999.

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Management's Discussion And Analysis

Statement Of Standards

1. A report that presents a Federal reporting entity's financial statements in conformance with Federal accounting principles should include management's discussion and analysis (MD&A) of the financial statements and related information. MD&A should provide a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should provide a balanced presentation that includes both positive and negative information about these topics. MD&A should be regarded as "required supplementary information" as that term is used in auditing standards.²
2. MD&A should contain sections that address the entity's:
 - mission and organizational structure;
 - performance goals, objectives, and results;
 - financial statements; and
 - systems, controls, and legal compliance.
3. MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the

²See section 558, "Required Supplementary Information," in *Codification of Statements on Auditing Standards*, American Institute of Certified Public Accountants (AICPA)

possible effects of anticipated future demands, events, conditions, and trends.³ Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

4. MD&A should discuss important problems that need to be addressed, and actions that have been taken or planned. Actions needed, taken, and planned may be discussed within the sections listed above or in a separate section of MD&A.
5. Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.
6. MD&A should deal with the “vital few” matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the GPFFR as a source of information. (The specific topics mentioned in *Concepts for Management’s Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:
 - lead to significant actions or proposals by top management of the reporting unit;
 - be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or

³The word “anticipated” is used in a broad, generic sense in this document. In this context the term may encompass both “probable” losses arising from events that have occurred, which should be recognized on the face of the basic or “principal” financial statements, as well as “reasonably possible” losses arising from events that have occurred, which should be disclosed in notes to those statements. “Anticipated” may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label “projected” or “projection,” and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity’s financial statements; however, preparers and auditors may find useful background information in the AICPA’s Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, “Financial Forecasts and Projections,” of the AICPA’s *Codification of Statements on Standards for Attestation Engagements*.

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- significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government.
7. Management of the reporting unit is responsible for the content MD&A.
 8. The standards are effective for reporting periods that begin after September 30, 1999.

This Statement of Recommended Standards was adopted unanimously by the eight members of the Federal Accounting Standards Advisory Board serving on the Board in April 1999.

Appendix A: Basis For Conclusions

Background, Rationale, and Project History

9. The Board identified MD&A as a topic for its agenda shortly after the Board's inception. The Board deferred work on this topic, however, until it completed recommendations for an initial set of basic accounting standards.
10. FASAB published an initial exposure draft on MD&A in January, 1997. It was presented as a statement of recommended concepts rather than standards. The Board proposed that it would deal with MD&A conceptually, with the understanding that OMB would provide authoritative guidance on MD&A to implement the concepts. This approach would have been similar to the one used to deal with the topics of entity and display. The Board dealt with those topics conceptually in SFFAC 2. OMB then provided authoritative guidance in its Bulletin on Form and Content.
11. The Board received comment letters on the initial exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Citizens, users, academics and others ⁴		4	4
Auditors	7	3	10
Preparers and financial managers	16		16
Totals	23	7	30

Concepts and Standards

12. The first exposure draft asked respondents whether all or part of the exposure draft's provisions should be issued as recommended standards rather than recommended concepts. Responses were mixed; most of those who commented on this question favored concepts, but a significant number expressed the view that standards

⁴This category includes representational organizations, retired federal employees, federal employees responding as individuals, and federal contractors, as well as academics and other GPFFR users.

would be appropriate. The Board concluded that, given the importance of MD&A as an integral part of the GPFFR, it would be appropriate for federal accounting principles to include standards for MD&A.

13. At the same time, the Board concluded that MD&A should be treated as required supplementary information. The Board agreed that it would recommend no detailed requirements or guidelines for MD&A at this time, beyond those in paragraphs 1-8. In other words, a discussion and analysis by management that addresses the listed topics should be required, because it is an essential part of a complete GPFFR. At the same time, management should have great discretion regarding what to say about those topics, subject only to the criteria in paragraphs 1-8 and the pervasive requirement that MD&A not be misleading. The standard itself, therefore, is not extremely prescriptive.
14. Because of this change from what was originally exposed for comment, the Board decided to expose separately the proposed standards and concepts for further comment. The exposure drafts were issued in October, 1998; responses were requested by January 1999. The proposed standard, like the final recommended standard, would require the auditor to note the omission of MD&A or the failure to address the specified topics. At the same time, RSI status for MD&A—coupled with the lack of specific, detailed, prescriptive standards for the content of MD&A—would minimize the requirement for the auditor to scrutinize MD&A. This, the Board believed, would provide the flexibility appropriate for dealing with topics such as performance measurement at this point in the evolution of federal financial reporting.

Responses to Second Exposure Draft

15. The Board received comment letters on the second exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)	Total
Citizens, users, academics and others		3	3
Auditors ⁵	3	3	6
Preparers and financial managers	11		11
Totals	14	6	20

16. Most comments were generally favorable, but comments were mixed regarding some points. A few auditors and preparers expressed some concern about requiring forward-looking information as RSI. Others expressed support for doing so. After considering these responses, the Board agreed to defer the recommended implementation date of the standard by one year and to make minor editorial changes to the standards and concepts that were exposed for comment.
17. Although the resulting standard differs from private sector standards, the Board expects that, in practice, the effect on auditors will not be greatly different.⁶ In the private sector, corporations frequently include with their annual financial report the MD&A that they are required to file with the SEC. Because it is required by the SEC rather than by accounting standards, the auditor engaged to audit the corporation's financial statements normally treats MD&A as "accompanying information" that is not audited in the context of the audit of the financial statements. The auditor also may review the submission to the SEC and may have certain responsibilities in that regard, but the auditor's usual role regarding MD&A is, nevertheless, fairly limited.
18. Because this standard defines MD&A for federal reporting entities as RSI, auditors will have certain responsibilities regarding it; however, both the accounting standards specified here and the auditing standards specified by the AICPA (and incorporated in Government

⁵Includes the AICPA's Federal Accounting and Auditing Subcommittee and the Comptroller General's Advisory Council on Government Audit Standards.

⁶The standard itself differs from the SEC's guidance for MD&A in ways that reflect the unique federal reporting environment. This will affect what financial statement preparers must do to comply with the standard. For example, reporting on performance of governmental programs requires measures in addition to net income or net cost.

Audit Standards) for RSI are rather general. Therefore, the Board does not expect that this standard will cause the auditor to be deeply involved in reviewing the contents of MD&A.

19. More specific requirements regarding the content of MD&A may be added later by OMB acting on its own authority or pursuant to future FASAB recommendations. For example, OMB might at some time in the future require preparers to address certain of the suggested items in Concepts for Management's Discussion and Analysis. OMB also may provide more specific guidance regarding the auditor's responsibility for MD&A. That guidance may call for more extensive review of all or parts of MD&A than the minimum contemplated by this accounting standard in the context of current auditing standards. For example, OMB might at some time in the future decide that the minimum scope of engagements to audit federal financial statements should be expanded to include a review or examination of all or parts of MD&A, consistent with attestation guidelines published by the AICPA.⁷

Accountability Reports

20. The Board notes that the concept and practice of the "Accountability Report" continue to evolve through the pilot project voluntarily undertaken by several agencies.⁸ The Board supports this evolution and encourages agencies to participate in the pilot project. The concepts and standards FASAB recommends are intended to be applicable to the GPFFR of Federal entities, whether those reports are prepared pursuant to the Chief Financial Officers Act, the Government Management Reform Act, or some future law that might establish a

⁷See Statement on Standards for Attestation Engagements No. 8, *Management's Discussion and Analysis*, issued by the Auditing Standards Board of the AICPA, March 1998.

⁸Accountability reports are broader in scope than traditional general purpose financial reports. As explained by OMB: "Six pilot agencies volunteered to produce an 'Accountability Report' for FY 1995 to provide more useful information to decision makers by linking together information required by several management statutes... Accountability Reports integrate the following information: the FMFIA report, the CFOs Act Annual Report (including audited financial statements); management's Report on Final Action as required by the IG Act; Civil Monetary Penalty and Prompt Payment Act reports; and available information on agency performance compared with its stated goals and objectives, in preparation for implementation of GPRA." *Federal Financial Management Status Report and Five Year Plan*, June 1996, pp. 33-34. Twelve agencies produced accountability reports for FY 1997; eighteen plan to do so for FY 1998; the number will increase to 23 for FY 2000. (The requirement to include Civil Monetary Penalty and Prompt Payment Act reports has been deleted.)

statutory basis for Accountability Reports. In the event of such future legislation, OMB will need to resolve any questions about how to apply existing Federal accounting standards in the context of new legislative requirements.

Forward-looking Information

21. MD&A should include forward-looking information regarding the future effects of existing, currently-known demands, risks, uncertainties, events, conditions and trends. This kind of forward-looking information is required when management believes it would be important to people who read the financial report. Though not required, MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends. FASAB encourages management to include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends to the extent management believes such information would be useful and relevant. This information can be highly useful, but management should avoid turning this part of MD&A into mere “lobbying” for more budgetary authority.

Incorporation by Reference

22. Some respondents expressed concern that, if MD&A is to be regarded as RSI, audit problems might arise from “incorporation by reference” in MD&A of information drawn from other sources that might not have been subject to audit or review as basic or required supplementary information, and for which authoritative guidance had not been provided by a standard setter. The Board noted that most of those who commented, including most auditors, did not appear to be greatly concerned about this potential problem. The Board concluded, therefore, that any such problems were not likely to be insurmountable. The Board did, however, agree to defer by one year the implementation date of the standard to allow OMB and GAO time to resolve any audit issues that may arise.

Statement of Federal Financial Accounting Standards 16: Amendments to Accounting For Property, Plant, and Equipment— Measurement and Reporting for Multi-Use Heritage Assets: Amending SFFAS 6 and SFFAS 8 Accounting for Property, Plant, and Equipment and Supplementary Stewardship Reporting

Status

Issued	July 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Volume II References	Federal Mission PP&E (F20), General PP&E (G20), Multi-use Heritage Assets (M40), National Defense PP&E (N20), Nonfederal Physical Property (N60), Property, Plant, and Equipment (P60), Required Supplementary Stewardship Reporting (R10)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 29 par. 14 rescinded SFFAS 16 in its entirety to incorporate all Standards related to heritage assets and multi-use heritage assets into one document.

...[SFFAS 29, par. 14 rescinded SFFAS 16 in its entirety.]

Statement of Federal Financial Accounting Standards 17: Accounting for Social Insurance

Status

Issued	August 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Volume II References	Stewardship Reporting (S70), Social Insurance (S40)
Interpretations and Technical Releases	
Affects	None.
Affected by	• SFFAS 26, par. 5, affects SFFAS 17, paragraphs 24, 27(3), 31, and 32(3) by changing the classification of information required by SFFAS 17.

Summary

This statement presents accounting standards for federal social insurance programs. The standards cover the following programs: Social Security (Old-Age, Survivors, and Disability Insurance), Medicare (Hospital Insurance [Part A] and Supplementary Medical Insurance [Part B]), Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. The standards do not cover any other programs at this time.

Social insurance programs have complex characteristics and thus require specialized accounting standards. These programs blend elements of exchange and nonexchange transactions and therefore do not completely fit traditional accounting notions of either annual governmental assistance programs (nonexchange transactions) or long-term pension programs (exchange transactions).

Because taxpayers rely on social insurance programs in their long-term planning, fundamental questions about social insurance programs include (1) whether they are sustainable as currently constructed and (2) what their effect on the government's financial condition will be. The requirements of this standard reflect the complexity of these programs. In its entirety, the information required will help users assess the government's financial condition and the sufficiency of future budgetary resources for these programs. No single element of the information required is sufficient to meet all the users' needs.

The standards require that a liability be recognized when payments are due and payable to beneficiaries or service providers. Supplementary stewardship information is to be reported to facilitate assessing the program's long-term sustainability and the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.

The information is required in the financial reports of both the individual agency and the governmentwide entity. The information is tailored for specific programs but generally includes narrative and/or graphic presentation of the following:

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- (1) long-range cashflow projections in nominal dollars and as a percentage of (a) the payroll that is subject to the tax earmarked for the program and (b) the Gross Domestic Product;
 - (2) long-range projection of the ratio of contributors to beneficiaries (commonly called the “dependency ratio”); and
 - (3) a statement presenting the actuarial present values of (i) future benefits and (ii) contributions and tax income for social insurance programs; the Statement of Social Insurance.

The Board is issuing this statement after years of debate. Taken as a whole, the package is a major step forward in meeting the objectives of federal financial reporting. Nonetheless, federal financial reporting is in a period of great change and the Board expects that further research regarding presentation of a federal balance sheet is needed. In Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, the Board acknowledged that an evolutionary approach would be taken:

The FASAB recognizes that developing and implementing standards that will contribute to achieving certain objectives may take considerable time. Time will be needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches. [par. 35]

The FASAB expects that some of these objectives may best be accomplished through means of reporting outside general purpose financial reports. Indeed, the FASAB recognizes that information sources other than financial reporting, sources over which the FASAB may have little or no influence, also are important to achieving the goals implied by these objectives. [par. 36]

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Purpose

1. The purpose of this statement is to establish standards for reporting information on social insurance programs that will assist users in evaluating operations and aid in assessing the government's financial condition and the sufficiency of future budgetary resources to sustain program services and meet program obligations as they come due. Social insurance programs were studied and analyzed during the Board's work on Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, and No. 8, *Supplementary Stewardship Reporting*. However, the Board decided to address the subject in a separate project.

Scope

2. This statement establishes accounting standards to be used by component entities and by the governmentwide entity for the following federal programs: Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security"), **Medicare**¹ Hospital Insurance (HI), Medicare Supplementary Medical Insurance (SMI), **Railroad Retirement** benefits, **Black Lung** benefits, and **Unemployment Insurance** (UI) for the general public. Accounting standards for UI for federal employees are provided in Statement of Federal Financial Accounting Standards No. 5 and are not within the scope of this statement. This statement should be applied only to programs listed in paragraph 14.

Background

3. As noted in FASAB's Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting (Objectives)*, the Federal Government is unique when compared with any other entity in the country. It is the vehicle that citizens of the United States use to exercise their sovereign power. It has continuing responsibility for the general welfare. It also has unique access to financial resources in that it has the power to tax, to borrow, and to create money.

¹See the [Consolidated] glossary (Appendix E) for definitions of terms used in the statement. Terms defined in the glossary are in **boldface** the first time they appear in the text.

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4. As a result of these responsibilities, the Federal Government engages in many activities that have no counterpart or that are a relatively small part of the activities in the private sector. The government is concerned, for example, with macroeconomic policies to maintain incomes during recessions and therefore provides unemployment compensation and other benefits. It is concerned with the distribution of income and therefore (1) provides a wide variety of welfare payments in cash and in kind to low-income households and (2) makes taxes and many kinds of benefits “progressive.” It is concerned about conditions and services in certain regions and communities, urban and rural, and therefore provides grants to state and local governments for various purposes. The fiscal year 2000 Budget of the United States reports that Social Security, Medicare, and other health and income security payments for individuals constituted more than 50 percent of the federal budget; grants to state and local governments comprised 15 percent.
 5. In *Objectives*, the Board established four major reporting objectives around which accounting standards should be organized. Taken together, they provide a framework for assessing the existing accountability and financial reporting systems of the Federal Government and for considering how new accounting standards might enhance those systems.² The four objectives are
 1. Budgetary Integrity,
 2. Operating Performance,
 3. Stewardship, and
 4. Systems and Controls.
 6. Although all the objectives are important, Nos. 2 and 3 directly impact the social insurance standards. Objective No. 2 provides,

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity’s assets and liabilities.³

²SFFAC No. 1, par. 109.

³SFFAC No. 1, par. 122.

As noted in *Objectives*, because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure “net income.” Moreover, directly measuring the value added to society’s welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relation to a variety of measures of the achievement of results. Information about social insurance that is relevant to this objective includes the cost of the program as well as long-range estimates (and ranges of estimates) of future costs and other obligations. Estimates of future costs highlight the cost impact of changes in benefit levels as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

7. Meeting Objective No. 3 is the other focus for this statement. It says,

Federal financial reporting should assist report users in assessing the impact on the country of the government’s operations and investments for the period and how, as a result, the government’s and the nation’s financial condition has changed and may change in the future.⁴

This objective is based on the government’s responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services but on the requirement that the government report the broad outcomes of its actions. Thus, federal financial reporting should provide information that helps the reader to determine

- whether the government’s financial position improved or deteriorated over the period,
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- whether government operations have contributed to the nation’s current and future well-being.

8. In light of Objective Nos. 2 and 3, fundamental questions about social insurance programs that can be addressed by accounting standards include whether the programs are sustainable as currently

⁴SFFAC No. 1, par. 134.

constructed, whether the government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs, and the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information required by this standard, taken as a whole, will help users make this assessment while acknowledging the complexity of the programs and the uncertainty of long-term projections.

9. To meet the objectives of federal financial reporting, the standards require that:
- (1) a liability be **recognized**⁵ when payments are due and payable to beneficiaries or service providers and
 - (2) supplementary stewardship information be reported to facilitate the assessment of:
 - (i) the long-term sustainability of the program from both an entity and a governmentwide perspective and
 - (ii) the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.
10. The RSSI includes:
- long-range cashflow projections,
 - long-range projections of the ratio between the number of those paying taxes earmarked for the program and the number of program beneficiaries, and

⁵The terms "recognition," "disclosure," and "required supplementary stewardship information" (RSSI) have specific, technical application in accounting. As explained further in the glossary to this statement, "recognition" (or "recognize") means formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, etc. "Disclosure" (or "disclose") means reporting information in notes or narrative regarded as an integral part of the basic financial statements. RSSI is information reported outside the principal financial statements that the Board considers essential to an entity's financial reporting and therefore recommends authoritative guidelines for its measurement and presentation.

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- actuarial present values of (i) future benefits for and (ii) contributions and tax income from or on behalf of current and future program participants.

SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

11. The specification of RSSI by the Board should not be construed as precluding management from voluntarily providing any additional information pertaining to the financial condition of its program that it believes useful and appropriate.

Materiality

12. The provisions of the accounting standards in this statement need not be applied to immaterial items.

Effective Date

13. The provisions of this statement would be effective for reporting periods that begin after September 30, 1999.

Accounting Standards For Social Insurance

14. The following programs are designated as social insurance and subject to these standards:
 - Old-Age, Survivors, and Disability Insurance (OASDI or “Social Security”);
 - Hospital Insurance (HI) and Supplementary Medical Insurance (SMI), known collectively as “Medicare”;
 - Railroad Retirement benefits;
 - Black Lung benefits; and
 - Unemployment Insurance (UI).

No other programs are subject to these standards, and the characteristics presented below should not be used to include other programs.

Characteristics Of Social Insurance Programs

15. These programs were developed to carry out the responsibilities of the government and generally have characteristics that make them unique. Although they generally share certain characteristics, “social insurance” programs are too diverse to allow definitive criteria to be applied to include some and exclude others from the category. This statement identifies the following five characteristics common among social insurance programs:

- (1) Financing from participants or their employers,
- (2) Eligibility from taxes/fees paid and time worked in **covered employment**,
- (3) Benefits not directly related to taxes/fees paid,
- (4) Benefits prescribed in law, and
- (5) Programs intended for the general public.

These characteristics are briefly described below.

Financing From Participants

16. Some of the resources needed to run these programs are raised through explicit taxes and fees collected from the program participant or from the participant’s employer. Taxes paid are usually a fixed percentage of the participant’s wage income.

17. Federal social insurance programs utilize “trust funds” to account for dedicated collections held for later use to accomplish the program’s purpose. Federal **trust funds** are accounts designated by law as such for receipts earmarked for specific purposes and the associated expenditure of those receipts. Trust funds serve useful purposes in allocating federal spending authority and accounting for earmarked taxes.

Eligibility from Taxes/Fees Paid and Time Worked in Covered Employment

18. Eligibility for benefits under social insurance programs usually rests, in part, on current or previous taxes and/or fees paid by the individual, the individual’s employer, or both, and the time worked in covered employment. Frequently an individual’s taxes and/or fees paid and time worked in covered employment also make family members eligible.

**Benefits Not Directly
Related to Taxes/Fees
Paid**

19. Social insurance programs sometimes intentionally redistribute toward lower-wage workers. Lower-wage workers tend to receive proportionately more in benefits relative to taxes paid than the higher-wage workers, sometimes much more. Many social insurance plans also subsidize benefits for nonworking members of workers' families and others.

**Benefits Prescribed in
Law**

20. Social insurance programs normally have uniform sets of entitling events; and schedules of benefits are developed, announced, and applied to all participants. Administrators of such programs have little discretion in determining who should get benefits or how much they should get.

**Intended for the General
Public**

21. These programs are intended for the general public and not solely for present or former federal employees.

**Component Entity
Accounting &
Reporting Standard**

**Expense & Liability
Recognition**

22. The expense recognized for the reporting period should be the benefits paid during the reporting period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (IBNR).
23. For Unemployment Insurance (UI), the liability to be recognized includes (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which they have not withdrawn funds from the federal unemployment trust fund (UTF) as of fiscal year end, and (2) estimated amounts to be withdrawn from UTF and benefits paid by states and territories after fiscal year end for compensable days occurring prior to fiscal year end.

Required Supplementary Stewardship Information

SFFAS 26 reclassified most RSSI as RSI. See SFFAS 26 for detailed guidance.

24. The entity responsible for the social insurance program should include in its financial report, as **required supplementary stewardship information** (RSSI), a clear and concise description of the program, how it is financed, how benefits are calculated, and its financial and actuarial status. The description should include a discussion of the long-term sustainability and financial condition of the program. A display should illustrate and the discussion should explain the trends revealed in the data. The entity should consider both narrative and graphic presentations. Statutory or other material changes affecting the program after the current fiscal year, including those enacted between the fiscal year end and the date of the report, should be described, along with the implications thereof. [See SFFAS 26.]
25. The projections and estimates used should be based on the entity's best estimates of demographic and economic **assumptions**, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.
26. All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.
27. The information on financial and actuarial status should include the following measures and data:
 - (1) *Cashflow Projections* - Projections of cashflow for those persons who are participating or eventually will participate in the program as contributors or beneficiaries during a projection period sufficient to illustrate long-term sustainability (e.g., traditionally the "Social Security," or OASDI, program has used a projection period of 10 years for relatively short-term and 75 years for long-term projections, and the UI program has used a projection period of 10 years for its projections). The projection should include current workers, retirees, survivors, disabled

persons, and new participants entering the workforce or becoming beneficiaries, including those who will be born or immigrate to the United States during the projection period. The information should include the following:

- (a) Actuarial projections of the annual cashflow, in nominal dollars, with amounts reported for at least every fifth year in the projection period. The cashflow information should show
 - (i) total cash inflow from:
 - 1) all sources and
 - 2) excluding net interest on intragovernmental borrowing/lending,⁶ and
 - (ii) total cash outflow.

The narrative accompanying the cashflow data should include identification of any year or years during the projection period when cash outflow exceeds inflow, both in total and excluding interest on intragovernmental borrowing/lending (the “cross-over points”), and an explanation of the significance of the “cross-over points.

- (b) The actuarial estimate provided in 27(1)(a)(i)2) and 27(1)(a)(ii) immediately above as a percentage of
 - (i) **taxable payroll**⁷ and
 - (ii) **Gross Domestic Product (GDP)**.⁸

⁶“Interest on intragovernmental borrowing” refers to interest earned by the social insurance program on obligations of the U.S. Government.

⁷Certain social insurance programs (i. e., SMI , Black Lung benefits, and UI) are either not financed by earmarked payroll taxes or are financed by state-determined payroll taxes on employers that can vary by state and by employer; therefore these programs are not required to provide this estimate.

⁸This requirement does not apply to the RRB, Black Lung, and UI programs.

- (2) *Ratio of Contributors to Beneficiaries* - With respect to the OASDI and HI programs, the ratio of the number of contributors to the number of beneficiaries (commonly called the “dependency ratio”) during the same projection period as for cashflow projections (e.g., 75 years), using the program managers’ best estimate.⁹ At a minimum, the ratio should be reported for the beginning and end of the projection period.

SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

- (3) *Actuarial Present Values* - For all programs except UI, a statement presenting the actuarial present value of each of the following:

All future expenditures during the projection period related to benefit payments:

- (a) to or on behalf of current participants who have not yet attained retirement age (e.g., the Social Security Administration has assumed an age of 15 years for new participants and an age of 62 years for retirement),
- (b) to or on behalf of current participants who have attained retirement age,
- (c) to or on behalf of those who are expected to become plan participants (i.e., new entrants) during a projection period encompassing substantially all the present value attributed to (a) and (b) immediately above;¹⁰

⁹SMI, Black Lung benefits, and UI programs are financed by, respectively, premiums paid by covered participants and general fund contributions (SMI); direct payments from employers, excise taxes per ton of coal, and general fund contributions (Black Lung); and state/employer-specific payroll taxes (UI). Therefore, these programs are not required to provide the ratio of contributors to beneficiaries. The OASDI trustees refer to the ratio of beneficiaries to contributors as the “dependency ratio.”

All future contributions and tax income (from taxation of benefits) during the projection period:

- (d) from or on behalf of current participants who have not yet attained retirement age (same group as in (a) above),
- (e) from or on behalf of current participants who have attained retirement age (same group as in (b) above),
- (f) from or on behalf of those who are expected to become plan participants (same group as in (c) above) during a projection period encompassing substantially all the present value attributed to (d) and (e) immediately above.

Net present value of cashflow during the projection period:

- (g) the actuarial present value of future contributions and tax income during the projection period [(d)+(e)+(f)] should be subtracted from the actuarial present value of future expenditures for the projection period related to benefit payments [(a)+(b)+(c)] to derive a total excess of future benefit payments over future contributions and tax income (or contributions and tax income over benefits).

Notes to the statement should present:

- (h) the accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date, and
- (i) a statement that the actuarial net present value of the excess of future expenditures related to benefit payments to or on

¹⁰A projection period for *future* participants would cover their working and retirement years. The entity would make an assumption about the length of this period. For example, the OASDI program uses a projection period of 75 years. A projection period for *current* participants (that is, for the people actually participating in the program) would theoretically cover all of their working and retirement years, a projection period that could be greater than 75 years in a few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years usually would not be material, and a 75 year projection period would include virtually all the future contributions, tax income, and benefit payments for current as well as future participants.

benefit of current participants, that is, of the “closed group” of participants (see (a) and (b) above), over future contributions and tax income from them or paid on their behalf (see (d) and (e) above) is calculated by subtracting the actuarial present value of future contributions and tax income paid by and for current participants [(d)+(e)] from the actuarial present value of the future benefit payments to them or on their behalf [(a)+(b)].

- (j) information required in subparagraphs 27(3)(a)-(h) for the current year and separate estimates for each of the four preceding years.

(4) *Sensitivity Analysis* -

- (a) For all programs except UI illustrate the sensitivity of the projections and present values required by paragraphs 27 (1) and 27(3) to changes in the most significant individual assumptions. For example, using the entity’s “best estimate” cost assumptions as a baseline, show the effect of varying several significant assumptions one at a time to show the effect on the projection. At a minimum the OASDI and Medicare programs should analyze assumptions regarding the birth and death rates, net immigration, the real wage differential, and the real interest rate. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI. The Medicare program should also analyze the health care cost factors and their trend.
- (b) For UI illustrate the sensitivity of the projections required by paragraph 27(1) to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).

- (5) *State-by-State Analysis* - For the UI program provide a state-by-state analysis illustrating the relative solvency of individual state programs. The analysis should provide the ratio of each state’s current accumulated fund balance to a year’s projected benefit

payments based on the highest level of annual benefit payments experienced by that state over the last 20 years.

Transition

28. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

Consolidated Governmentwide Entity Accounting & Reporting Standard

29. The standard for consolidated governmentwide accounting and reporting for social insurance programs is the same as that for component entities except as provided below. Thus, except for the specific modifications listed below, the governmentwide entity should refer to the relevant paragraphs of the standard for component entities in the preceding section for a description of the information to be provided.

Expense & Liability Recognition

30. Expense and liability recognition for the consolidated governmentwide entity are the same as for the component entities (see pars. 22-23).

Required Supplementary Stewardship Information

31. The consolidated governmentwide financial report should include, as required supplementary stewardship information (RSSI), a summary of the entities' descriptions of their social insurance programs (see paragraph 24). The description should include a discussion of the long-term sustainability and financial conditions of the programs, illustrate and explain the trends revealed in the data, and explain the relationship of the social insurance program(s) to governmentwide financing, especially regarding the intra-governmental nature of trust fund assets and government debt.
32. The information on financial and actuarial status should include the following measures and data:
- (1) *Cashflow Projections* -
- (a) Cashflow projections should be made for all social insurance programs as described under the component entity standard (see par. 27), except that only cash inflow

from the public (that is, excluding interest on intragovernmental borrowing/lending) and total cash outflow are required. At a minimum the OASDI, HI, and SMI programs should be separately identified. The projection period of the display should be based on those used by the component entities, which may require summarization or presentation techniques such as using more than one graph (e.g., a 10-year graph and a 30-year graph). The presentation should include an explanation of material crossover points, if any, where cash outflow exceeds cash inflow and the possible reasons therefore.

- (b) For the programs indicated immediately below, estimated future cash inflow (excluding net interest on intergovernmental borrowing/lending) and outflow for the projection period described in paragraph 27 as a percent of
 - (i) taxable payroll for OASDI and HI, presenting each program separately, and
 - (ii) GDP for OASDI, HI, and SMI, presenting each program separately.
- (2) *Ratio of Contributors to Beneficiaries* - For OASDI and HI, the ratio of the number of contributors to the number of beneficiaries (commonly called the “dependency ratio”) during the projection period as described under the standard for component entities (see par. 27(2)).

SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

- (3) *Actuarial Present Values* - For all programs except UI provide a statement combining the entity statements required in paragraph 27(3)(a)-(i). The presentation should include data for the current year and separate estimates for each of the four preceding years. At a minimum OASDI, HI, and SMI should be separately identified.

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- (4) *Sensitivity Analysis* - For all social insurance programs provide a summary of the sensitivity analyses required under the standard for component entities (see par. 27(4)). At a minimum the summary should present the OASDI, HI, SMI, and UI separately.
 - (5) *State-by-State Analysis* - Provide a summary of the state-by-state analysis required for the UI program (see par. 27(5)).

Transition

- 33. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

Appendix A—Basis For Conclusions

Section 1 — Response To Comments Received

34. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important matters that the FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.
35. FASAB published the exposure draft *Accounting for Social Insurance* in February 1998. The exposure draft included five questions and invited comments on the usefulness of the proposal for accounting and reporting for social insurance. Twenty-nine letters were received from the following sources:

	Federal (internal)	Nonfederal (external)	Total
General Public [retired employees]	2	8	10
Auditors	3	4	7
Preparers and Financial Managers	12	0	12
Total	17	12	29

36. FASAB also held a public hearing on the exposure draft on October 5-6, 1998. Testimony was received from representatives of accounting, auditing, and actuarial organizations; from a public service organization; and from the Social Security and Medicare programs. Appendix C, Historical Background, provides a history of past accounting for these programs.
37. Section 1 of this basis for conclusions addresses certain responses to the exposure draft and the comments received at the public hearing.
38. The responses to the exposure draft illustrate what was described in the basis for conclusions for the exposure draft as two polarized views regarding recognizing or even disclosing a liability measure beyond the due and payable amount called for in this standard. Some respondents restated their views on the propriety of the accounting

proposed in the ED, and/or they said they favored one or the other of the two opposing views described in the basis for conclusions. Some respondents argued once again that social insurance programs are pay-as-you-go, income transfer programs for which an estimate of accrued and future benefits and contributions and tax income is inappropriate. Other respondents reiterated the contrary argument. They said that such programs are commitments for which a long-range accrual is not only appropriate but also essential for the balance sheet, if the information presented therein is not to be misleading.

39. The Board continues to believe that the original basis for conclusions in the exposure draft describes and explains the Board's conclusions adequately. Therefore, except for those issues specifically discussed immediately below, the Board is presenting the original basis for conclusions from the exposure draft in Section 2. Changes were made where necessary to reflect the requirement for a statement of social insurance in the final standard.
40. In response to comments received on the exposure draft and subsequent public hearing, the Board is adding a requirement for a statement presenting the actuarial present values (APV) of future benefits for and future contributions and tax income from or on behalf of all current and future participants during the projection period normally used by the programs. For example, the OASDI program uses a 75-year projection period. The net total of the statement will present the total excess of benefits over contributions and tax income.
41. The Board believes that this information will be useful in analyzing the sustainability and financial position of SI programs. The added detail on individual components of the actuarial net present value will provide analysts interested in different facts with useful detail. In addition, the statement presentation will increase the prominence of important data otherwise obscured in a long narrative.
42. The Board has considered whether the changes made regarding the presentation of actuarial present values requires re-exposure. The original exposure draft focused on one net actuarial present value, for the "closed group," while the final standard presents the components of that value as well as data on future participants. Also, the exposure draft proposed subtracting the fund balance at the valuation date from the actuarial present value of the net cash outflow over the projection

Expanded Presentation and
Visibility of Actuarial
Present Values

period, while the standard now calls for fund balance information to be presented in a note to the statement.

43. The Board decided that the new presentation and data did not require re-exposure. The information added to the standard results from adding more detail and modifying the display to increase visibility. These modifications are responsive to the views expressed by many during the comment period. The Board believes that the difference in the presentation does not warrant delaying the issuance of the standard.
44. A few of the respondents disagreed with the approach in the exposure draft whereby programs are specifically identified. One respondent reasoned that an accounting standard would be more useful if it established definitive criteria for current and future programs to meet rather than designating only specific programs. Conversely, another respondent said the standard should be even more specific and deal with the individual programs separately because some have characteristics of defined benefit plans while others are similar to welfare programs.
45. After weighing these arguments carefully, the Board continues to believe that definitive criteria would be unworkable. Although these programs do generally share certain characteristics, they are complex. Each program has unique benefits, different eligibility requirements, and different financing arrangements. Because definitive criteria would be subject to interpretation, questions would arise about individuals programs that would require a response from the Board. The Board has decided to identify social insurance programs that now exist and consider the classification of other programs as they may arise in the future.
46. Several respondents to the exposure draft expressed concern that projections of cashflow and GDP would not be consistent between entities and within an entity due to the use of different assumptions by separate programs. One respondent believed that cashflow estimates as a percentage of GDP would not be meaningful without a tremendous amount of effort and cost expended in coordinating assumptions and methodologies to achieve consistency.
47. The Board considered these arguments and decided not to require uniform assumptions. The assumptions used by Social Security and

Specific Identification of Social Insurance Programs

Consistency of Assumptions

Medicare, the two predominant programs, will be consistent. These programs use the same principal assumptions and have the same **trustees**. On the other hand, the Board concluded that the GDP projection should not be required of smaller programs and therefore explicitly exempts them from that requirement.

Sensitivity Analysis

48. Some respondents disagreed with the approach in the exposure draft regarding sensitivity analysis, which calls for showing the effect of changing one major assumption at a time. One respondent favored a general requirement that entities provide sensitivity analysis rather than telling them how to do it. This respondent favored the high-, low-, and intermediate sets of cost assumptions that are featured in the trustees' annual reports for Social Security and Medicare. Another respondent suggested that the standard not require sensitivity analysis because most users would not understand it and the potential for misuse would be great. Another respondent said that the requirement in the standard was useful because it gives an idea about the uncertainty associated with the estimate. However, this respondent said sensitivity analysis was inadequate without a further discussion of the nature of uncertainty itself and recommended mandating such a discussion.
49. The Board continues to believe that the analysis required by the standard is a clear, easily understood illustration of the sensitivity of projections to changes in assumptions. The Board recognizes the difficulty in illustrating the uncertainty inherent in all projections, especially very long-range projections. However, the requirement in the standard would not preclude the entity from presenting additional discussions of uncertainty and the Board expects that agencies would do so voluntarily.

State and Local Government Pension Accounting

50. Some respondents urged the Board to consider whether the approach used by state and local governments to account for employee pensions would be suitable, at least for some social insurance programs that are most analogous to pensions, such as the retirement benefit portion of Social Security. Those respondents focus on similarities, such as defined benefit formulas tied to earnings.
51. The Board concluded that there are important differences in the programs and environments involved. For example, state and local pension plans typically do not have extensive income transfer features. They are much like federal employee pension programs,

which are not considered to be social insurance. On balance the Board concluded that such an approach would be inappropriate.

Vote of Approval

52. This recommended statement was approved by the Board with a vote of 6 members in favor of its issuance and 3 member(s) opposing its issuance. Two members submitted written dissents, which are available for public inspection at the FASAB's offices.

Section 2 — Basis For Conclusions From The Exposure Draft

[Note: The Board's recommendation differs from the proposal made in the exposure draft. Certain sections from the basis for conclusion in the exposure draft were deleted since they are no longer relevant to the final recommendation. Paragraphs 40-51 explain the differences and reasons therefore.]

53. The following paragraphs address the basis for the Board's proposals on

- defining social insurance,
- recognition of liabilities and expense for social insurance, and
- required supplementary stewardship information (RSSI).

Characteristics of Social Insurance Programs

54. As stated in the introductory sections, the Board has analyzed certain programs that are generally considered social insurance. These programs have certain characteristics that set them apart from general assistance programs on the one hand and insurance programs on the other hand. Accounting standards for liabilities associated with general assistance and insurance programs are provided in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.
55. After analyzing specific programs, the Board determined that, although these programs generally shared certain characteristics, their operational features were too diverse for establishing definitive criteria that would include all the subject programs and exclude all other federal programs for which accounting standards have already been provided. Thus, the Board has outlined the general characteristics that social insurance programs usually—but not always—possess and has listed the specific programs to which the standards apply. This does not preclude the Board from considering an additional program(s) in the future and, given the individual circumstances pertaining to that program, including it within this

statement. However, no entity on its own volition should apply this statement to any program not listed in this statement.

56. Accounting for UI for federal employees is provided in SFFAS No. 5 and is not within the scope of this standard. SFFAS No. 5 provides that the unemployment program for federal employees should be accounted for like other postemployment benefits (e.g., severance benefits and workers' compensation) because the nature of the liability is similar. Federal employer entities must reimburse the Labor Department for the full cost of unemployment benefits received by former federal employees rather than paying a payroll tax each period.

Nature of Social Insurance

57. In determining how social insurance program transactions should be recognized in the financial statements and the supplementary information that should be provided about them, the Board considered the nature of the Federal Government, the nature of those programs, and the needs of users of federal financial reports. Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting*, notes the Federal Government's unique responsibilities for the common defense and general welfare and its unique access to financial resources and financing, including the power to tax and create money. The government undertakes many programs despite potentially unfavorable effects on its financial condition, and transactions between citizens and the government generally are not individual exchanges between willing buyers and sellers.¹¹

58. Consideration of guidance for the recognition, measurement, and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The programs are complex, reach a unique order of magnitude, and involve projections that are extremely sensitive to assumptions whose range of possibilities is large.

Expense & Liability Recognition

59. The Board believes that the annual expenses of such programs should be the benefits paid during the accounting period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period, including claims incurred but not

¹¹SFFAC No. 1, *Objectives of Federal Financial Reporting*, pars. 52, 53, 55, and 60.

reported. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, and supplementary stewardship information should be provided as described in the standards.

Exchange and Nonexchange Transactions

60. During its consideration of social insurance and, before that, of liability accounting, the Board considered whether social insurance programs result in **exchange** or **non-exchange transactions** or whether they contained features of both. As described in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, nonexchange transactions give rise to a different kind of obligation than exchange transactions under federal accounting principles.
61. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. However, for a nonexchange transaction, a liability is recognized for any unpaid amounts due and payable as of the reporting date, including estimates of claims incurred but not yet reported.
62. As defined in SFFAS No. 5, obligations become liabilities against the Federal Government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing the liability recognition point among various federal programs is whether a nonexchange transaction is involved. Although a high probability may exist that a grant, a subsidy, or an income transfer will be made or will continue to be made in future years, the recipients do not have as high an equitable claim to receive grants, subsidies, or transfers in the future as do those who exchange service for promises of future payments. The latter have a greater probability of being paid than the former. At the same time, many people feel that some social insurance benefits, Social Security in particular, also have similar “exchange” or “equitable” claims. They also believe that social insurance benefits have as great a probability of being paid as any other payments.
63. Whether on the balance sheet or elsewhere in the financial report, estimates of the future amounts required to continue present policies regarding such programs are relevant to certain decisions and should

be disclosed or otherwise reported. In the context of the Board's definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute a liability.¹²

Polarization

64. With regard to social insurance, the Board notes the strength of feelings on this issue. The Board has been faced with two polarized views. On the one hand there are those who believe a liability should be recognized for the net benefits expected to be paid in future periods to current participants. On the other hand, there are those who believe that the long-term obligation (i.e., beyond amounts due and payable at the end of an accounting period) associated with these programs is not a liability and should not be recognized as such. Some people also believe such amounts should not be reported as RSSI.

Arguments against Recognition, Disclosure, or Supplementary Reporting

65. The latter group would argue that social insurance programs do not result in exchange transactions, that social insurance programs are income transfers financed primarily by compulsory earmarked taxes and also, in certain cases, general revenues of the government. For them, the political nature of the commitment is critical, for its terms can be and are changed by the Congress to maintain **actuarial balance**. In this regard, they point to *Flemming, Secretary of HEW v. Nestor, Part I* (363 U.S. 608-611) wherein Mr. Justice Harlan, delivering the opinion of the Court, said,

[T]he entire [Social Security System] rests on the legislative judgment that those who in their productive years were functioning members of the economy may justly call upon that economy, in their later years, for protection from the 'rigors of the poor house'...

He continued,

It is apparent that the noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity, whose right to benefits are bottomed on his contractual premium payments.... *To engraft upon the Social*

¹²SFFAS No. 5, pars. 129-131.

Security System a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands. (Emphasis added.)

66. Those who believe that only the due and payable amount should be recognized as the liability would argue that, under social insurance, the government uses its sovereign power to require payment of taxes that it dedicates to finance benefits. The individual beneficiaries of these programs are receiving payments that may be indirect and disproportionate to the taxes paid by them or on their behalf. In the case of Social Security, the oldest social insurance program, those who retired in the first years after enactment in 1935 received benefits that were many times their taxes. This was possible because the system transfers resources across generations. The system transfers resources within a generation as well, from those working and paying taxes to the disabled, the surviving spouse, and dependent children.
67. They would argue that benefits have also been very different by family type, wage level, and sex. One-earner couples receive benefits that are far larger than taxes paid, followed by two-earner couples. Single females have still lower benefit/tax ratios, followed by single males. Low-wage earners have a higher benefit ratio than those with average or high wages. For each type of recipient, benefit/tax ratios have been trending down. High- and average-earning single males retiring now cannot expect to get their money back, with interest; and this will soon also be true for high-earning single females.¹³
68. Some of those who do not believe that social insurance obligations constitute a liability argue that the level of future benefit payments is too uncertain for accrual as a liability. They point out that not only did Congress expressly include (and retain) the right to alter, amend, or repeal any provision in the **Social Security Act** itself, it has made such changes frequently. In the early years, the changes generally expanded benefits—for example, to dependents, the disabled, and early retirees; to a broader coverage of workers; to protect retirees against inflation—and increased tax rates. But as the system has matured, the changes have increased the tax rate further, taxed an increasing proportion of benefits, reduced cost of living adjustments

Uncertainty

¹³See Steuele, C. Eugene, and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, (The Urban Institute Press, Washington, DC).

and various benefit provisions, and prospectively raised the retirement age.

69. They argue further that the benefit payments that might be made in the future are dependent on economic and demographic variables including the growth of real wages, interest rates, births, immigration, and labor force participation. The aggregate benefits under the **high cost Social Security assumptions** in 2070 are estimated by the Social Security Trustees to be 2.5 times those under the **low cost assumptions**. And the estimates change over time. The legislative changes in 1983 were expected to maintain a positive fund balance until 2063; however, by current **intermediate cost assumptions** the fund will run out three decades sooner.

Period Costs

70. Some argue that the critical issue is the period to which a particular cost or expense relates. They emphasize that a significant determination in accounting is to decide in which period a transaction should be recognized as an expense. They believe that social insurance benefits, like other non-exchange transactions, should be recognized as expenses in the time period when they are paid or are due and payable and not earlier when a participant has covered wages. Future social insurance benefits constitute program costs of future periods, notwithstanding that they may be for the purpose of carrying out responsibilities that the government has already assumed.
71. They would argue further that, given the nature of the Federal Government and of social insurance, liability-type measures of the social insurance obligation (e.g., the closed group measure...) are meaningless or even potentially misleading. In particular, they argue that this information would not be useful to assess sustainability. It ignores the pay-as-you-go financing, excludes future earmarked taxes from future participants, and results in such an enormous **actuarial present value** that it may needlessly scare those unfamiliar with the debate. Such measures do not reflect the way the program is financed under current law and could, if taken out of context, imply that the current participants have a right to benefits superior to future participants.
72. They argue that other supplementary information would provide useful sustainability information. For example, the Social Security Trustees' annual report provides "open group" projections of cashflow—in dollars, as a percentage of the tax base earmarked for

the program, of the GDP, etc.—and the “dependency ratio.” The open group measure reflects the way the program is financed; and the dependency ratio—the ratio of contributors to beneficiaries—indicates whether the program could potentially encounter stress in the future. Both of these were proposed in the exposure draft on social insurance as part of the supplementary information. They argue that these and other measures provide meaningful sustainability information.

Arguments for Recognition,
Disclosure, or
Supplementary Reporting

73. Those who hold a contrary view believe either that the distinction between exchange and non-exchange transactions is not relevant to the liability recognition or supplementary reporting issue or that the programs possess characteristics that make the transactions predominantly exchanges. They argue that social insurance programs possess certain characteristics that, taken together, cause the criteria for recognizing a liability to be met long before payments are due and payable. Those characteristics are
1. the contributory nature of the program (i.e., benefits are predicated to some extent on prior payments),
 2. time in covered employment,
 3. government sponsorship,
 4. benefits prescribed in law, and
 5. specific accounting entity (e.g., the trust fund) and long-range financing.
74. These characteristics, in conjunction with the historical experience and political climate affecting the programs, create obligations and societal expectations that make the outflow of resources highly probable — far more than 50 percent. Therefore, an accounting liability should be recognized at an earlier point than when payments are due and payable; and the liability should be based on long-term or actuarial estimates of future payments.
75. Supporters of this view note that social insurance programs, as distinguished from general assistance programs, require the payment of taxes in order to establish an “insured status” before an individual is eligible for benefits. This is often referred to as an “earned right to benefits.” In addition, most such programs have an element of individual equity in their benefit formulas whereby greater levels of taxes result in greater levels of benefits — although Medicare HI is a notable exception. Moreover, both the participant and the employer

sacrifice value in anticipation of future benefit. Not only do the participants anticipate retirement benefits as a result of these sacrifices, many employers, including the Federal Government, build in the value of Social Security benefits when designing retirement plans. Those holding this view would argue that these factors make social insurance programs predominantly exchanges.

76. Some of those arguing for recognition or **disclosure** believe that social insurance programs are constructive liabilities and that users of financial statements are accustomed to seeing commitments as firm as these quantified in financial statements or in notes to the statements. Some say that there is little conceptual difference between the liability that is recognized for federal pensions and the closed group obligation for social insurance. They would say that the failure at least to disclose a liability-type measure of the obligation therefore would potentially be misleading to those who relied on the financial statements and would raise questions about the credibility of the statements.
77. In addition, they believe that the closed group number is a measure of the intergenerational transfer implicit in the program under its current terms and that this number should be reported. They would argue that the failure to disclose this number makes these programs look healthier than they are and thus may lead to poor decisions about consumption and saving by Congress and by citizens. Those who hold this view would argue that a closed group measure that treats social insurance benefits as earned annually would help users to understand the extent to which social insurance programs have committed future-year taxpayers to finance amounts earned by participants as of a given point in time.
78. Some of those who argue that a liability should be recognized on the balance sheet maintain that most of the financial reporting community in the United States have adopted a different standard than exchange or nonexchange. The Financial Accounting Standards Board (FASB) concept statements adopt an “asset/liability” perspective in which what matters is whether a promise has been made, not whether something has been received for it or how it will be funded—in other words, what matters is whether a future sacrifice of resources is probable, regardless of whether it arises from an exchange of consideration. From this perspective, the only reason for not recognizing a liability for the amount promised by the social insurance program would be the assumption that it may not be paid.

79. Because most users are familiar with FASB's definition, or at least are accustomed to seeing financial reports based on it, those who favor recognition or disclosure of a liability-type measure argue it is inherently misleading to fail to quantify the size of the promise that is continually being made and on which people are told they can rely. While many who support liability-type disclosure agree the open group data are desirable to aid in assessing the sustainability of social insurance programs, they also believe that an assessment of the financial condition of the program — and more importantly, of the Federal Government — is not possible absent liability or closed group data. If a reader seeks to answer the question — Have we burdened future generations of citizens with the cost of the current and past years? and, if so, to what extent? — the very large obligations for social insurance must be considered.

The Board's Conclusion
Regarding Recognition,
Disclosure, or
Supplementary Reporting

80. The Board acknowledges that it is faced with two polarized views without much hope of one side convincing the other side of the correctness of its position. On the one side are those who believe that social insurance programs — especially Social Security and Medicare — constitute a liability of the Federal Government that should be recognized on the consolidated balance sheet and that the closed group is the best measure of it. They agree that other measures such as a long-range projection of a program's cash inflow from all sources and outflow for all purposes are also useful, and note that all measures of sustainability and financial condition must be taken in context to be meaningful. At the opposite pole are those who firmly believe that the closed group measure is meaningless or even potentially misleading and should not be disclosed at all in the financial report.

81. The Board recognizes that both approaches have limitations and that the data are best understood when used together. An "earned right" measure, for example, produces a relatively large dollar amount that could confuse the reader who is unaware of the way in which the program was intended to be funded. Although both sides make strong arguments, no empirical evidence has been offered that would prove one side right and the other wrong. The Board believes the best approach to resolve this issue is for the closed group data to be reported off the balance sheet as part of a balanced RSSI package of disclosures about the Social Security and other social insurance programs. *[The Board subsequently affirmed that the data necessary to calculate the closed group measure should be reported. See*

paragraphs 40-43 for a discussion of the Board's final recommendation.]

82. The Board believes such disclosure will provide useful information and also serve the interests of users who are concerned primarily with federal accounting in its entirety. The Board has heard much from the two opposing sides, within the Federal Government, with the keenest interest in this issue. It does not forget, however, a larger third group of constituents, both within and outside the Federal Government, who are concerned with federal accounting in its entirety.
83. The Board believes that these users would consider social insurance accounting in general and Social Security accounting in particular to be important but only as one element of the complex of problems in federal accounting that led to the establishment of the FASAB. A closed group measure of some type undoubtedly will be provided to this group of users from some source if it is not provided based on government standards. These users will be better served if the Federal Government defines a credible measure, calculating it by using assumptions consistent with other Social Security and other social insurance program estimates, and disclosing it with explanatory materials and in a governmentwide and national context.
84. Considering the polarity of these positions, the Board is persuaded that the requirements incorporated in this statement best serve the users of federal financial information. The Board continues to believe that, given the strength of these differing views concerning the nature of social insurance transactions, an overriding concern exists that no single measurement on the balance sheet or elsewhere could adequately convey the financial sustainability of social insurance programs or the impact on the financial condition of the administrative entities or the government as a whole. Using Social Security as an example, one could approach measurement from the perspective of an obligation to participants based on earned rights to future benefits; or one could approach measurement from a pay-as-you-go funding perspective, giving consideration to both future inflows and outflows. Projections based on a pay-as-you-go approach would acknowledge the way in which Social Security is funded and provide data on long-range sustainability based on the current benefit structure. An "earned rights" approach would acknowledge that, at any given point in time, Social Security has \$X of accumulated

Measurement of Social Insurance Obligations

obligation to current participants that would need to be provided by future generations under current law.

85. The Board believes that a more complete picture of the financial condition of the government can be provided by a forward-looking assessment of whether it can “sustain public services and meet obligations as they come due.” The users of federal financial information need to know a great deal about the future of social insurance programs, a large and growing proportion of federal spending with financing that is under demographic and other strains. Understanding the financial condition of these programs is important to understanding the condition of the Federal Government as a whole. In addition, many citizens depend on these programs for their own financial security. The Board therefore believes that useful information about the future prospects of these programs should be fully and impartially presented in the financial reports of entities operating these programs and in the consolidated financial report of the United States government. The social insurance standards set forth the minimum information that the Board believes necessary for that purpose.

Required Supplementary Stewardship Information

86. The Board believes that the required information is relevant for assessing the sustainability of social insurance programs and also bears on the government’s financial condition. The following paragraphs discuss each of the RSSI elements.

Cashflow

87. An estimate based on the amount and timing of future cash inflows and outflows will help users understand the long-range sustainability of the social insurance programs based on current revenue and benefit structure. The Board believes that the yearly inflows and outflows under the open group method should be disclosed over a sufficient number of years (e.g., 10 years, 75 years) to display “crossover” points where outflows begin exceeding inflows. Crossover points provide an early warning as to the need to adjust either the revenue stream or the expenditure stream to ensure that the program is sustainable under current law.

88. The Board considered specifying the length of the projection (e.g., 10-20 years). However, it decided that allowing the entity to use its traditional timeframe was preferable, if the period presented is long

enough to reveal anticipated critical points as mentioned in the preceding paragraph.

Percentage of Taxable Payroll & GDP

89. Cashflow should also be put in relation to the taxable payroll or other tax base earmarked for the program, the GDP, or other benchmark that would be meaningful to users. The sustainability of a social insurance program cannot be determined solely on the basis of the financial position of the Federal Government. Rather, the size of the total fiscal burden shifted by government to future taxpayers—in relation to their ability to bear it—is critical to that determination. Thus, sustainability from the governmentwide perspective is better measured in terms of a healthy relationship between social insurance programs—and, indeed, the entire budget—and the national economy, as measured by the GDP or taxable wages.

Dependency Ratio

90. The ratio of contributors to beneficiaries, also commonly called the “dependency ratio” shows the estimated number of contributors (e.g., **covered workers**) per program beneficiary. The Board believes that a projection of the trend in the relationship between contributors and beneficiaries should be displayed. This ratio helps readers assess whether the program is under potential stress and whether it is sustainable as currently constructed. A deteriorating dependency ratio would illustrate the effect of demographic trends on relationships between contributors and beneficiaries that may affect the sustainability of the program as currently constructed.

The “Closed Group” Measure

[The social insurance exposure draft proposed that the net APV for the closed group of participants be reported as RSSI. As explained in paragraphs 40-43, the final standard requires information about the closed group APV, within the structure of the new statement of actuarial values, and an explanation of how to calculate it. See note No. 3 of the illustrated statement of social insurance, page 46. The closed group measure proposed in the exposure draft represented the actuarial net present value of (a) the future benefit payments to current participants, (b) future contributions to be made by them and their employers, and (c) the accumulated excess of cash receipts

over cash disbursements within the social insurance program represented by fund balance at the valuation date. The Board continues to believe that the closed group measure is useful, and that the following paragraphs from the exposure draft retain their cogency.]

91. The closed group measure is sometimes referred to as an actuarial liability¹⁴ for certain social insurance programs relating to the closed group of current participants. Some believe it is analogous to the liability that would be recognized on the face of the balance sheet if social insurance programs were accounted for like federal pension and retiree health care benefits. Others dispute this, pointing to different financing arrangements, legal status, and the nature of social insurance and pensions.
92. Until 1985, the “prototype” *Consolidated Financial Statements of the United States* recognized a liability for Social Security, using a calculation similar to that called for by Opinion No. 8 of the Accounting Principles Board, *Accounting for the Cost of Pension Plans*, (APB 8). This liability was calculated by amortizing the “closed group” obligation and recognizing as a liability the unfunded portion that was amortized each year. APB 8 defined a variety of acceptable methods for measuring pension expense and required that any unfunded pension expense be recognized as a liability. APB 8 was superseded by Statement 87 of the Financial Accounting Standards Board (FASB), published in December 1985. FASB published Statement 87 to make accounting for pensions more independent of the financing arrangements, to provide more standardization in measurement of the pension expense and liability, and to require that at least a “minimum liability” be recognized in employers’ Statements of Financial Position (balance sheets). From 1985 through 1994, the closed group amount was disclosed in a footnote in the *CFS*.
93. Some people believe that the closed group measure is analogous to the measure of “risk assumed” that would be reported as supplementary stewardship information if social insurance programs were accounted for like other federal insurance programs. SFFAS No. 5, *Accounting*

¹⁴[A variety of actuarial methods exist which can be used to calculate an actuarial liability. The “closed group” measure is not identical to the methods that would be used in pension accounting. See paragraph 97]

for Liabilities of the Federal Government, defines “risk assumed” as the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force (i.e., the expected loss on the “current book of business”). In the context of social insurance, one would use the term “closed group” instead of “current book of business.”

94. SFFAS No. 5 requires insurance programs, other than social insurance programs, to report the risk assumed amount if it differs from the amount recognized as a liability. (SFFAS No. 5 exempts federal life insurance and loan guarantee programs from this disclosure requirement because the relevant accounting standards already incorporate a similar concept in determining the amount to be recognized in the financial statements.) Some people believe that it is useful to report this information, for the same reason that it is useful to report it for other kinds of government programs. This reason was summarized in a report on budgeting for federal insurance programs other than social insurance. Although FASAB is concerned with financial reporting, not budgeting, the underlying rationale is similar:

As a general principle, decision-making is best informed if the government recognizes the costs of its commitments at the time it makes them. For most programs, cash-based budgeting accomplishes this. However, for insurance programs, accrual-based budgeting, which would recognize the expected long-term cost of the insurance commitment at the time the insurance is extended, offers the potential to overcome a number of the deficiencies of cash-based budgeting by improving cost recognition. In concept, recognition in the budget of the risk assumed by the government would permit policymakers to consider these costs in relation to other funding demands and would improve the measurement of a program’s impact on private economic behavior. In most cases, the risk-assumed approach to accrual would be analogous to a premium rate-setting process in that it looks at the long-term expected cost of an insurance commitment at the time the insurance commitment is extended. The risk assumed by the government is essentially

that portion of a full risk-based premium not charged to the insured.¹⁵

95. Other people believe that, because there has been no intent for individuals or cohorts of individuals (generations) to make contributions commensurate with the benefits they receive (as would be the case in other kinds of insurance programs), it would be misleading to report the amount of this intergenerational transfer implicit in social insurance.
96. The Board believes that ... the closed group measure represents a reasonably good estimate of the net responsibility of future participants, under current laws, to pay benefits to current participants. Although this amount is subject to change due to changing long-range demographics, it is not as volatile as the computation under the “open group” method that includes all current and future participants over the next 75 years since it relates only to individuals who already are participating in the program.
97. Some people note that the closed group measure, in addition to being an important factor in assessing the financial position and condition of the program and of the government, also represents a rough estimate of the maximum “transition cost” of the program if it were to move from the present pay-as-you-go system to one that, like most pension plans, sets aside resources during workers’ careers to finance the benefits they will receive after they retire.¹⁶ The primary reason for reporting the size of this implicit liability in general purpose federal financial reports is to ensure that the financial report fairly presents the financial position, condition, and results of operations of the

Transition Costs

¹⁵Budget issues: Budgeting for Federal Insurance Programs, General Accounting Office, GAO/AIMD-97-16, Sept. 30, 1997, p. 5.

¹⁶Several ways exist for measuring transition costs depending on, among other things, whether one assumes the current program will continue for current participants alongside a new program for new participants (similar to federal employees continuing with the Civil Service Retirement System after the creation of the Federal Employee Retirement System in 1983). In such a transition, the older program would be closed to new entrants. Another type of transition would be where the current participants will move on to the new system, with the transition cost being the amount owed them under the former program. The discussion of different methodologies for calculating transition cost is beyond the scope of this accounting standard; but see the Stephen Goss, “Measuring Solvency in the Social Security System,” *Prospects for Social Security Reform*, ed. Olivia S. Mitchell, Robert J. Myers, and Howard Young (Philadelphia: University of Pennsylvania Press, 1999), 16-36.

reporting entities involved. It is also true, however, that this number is one way of quantifying the financing challenges relating to changing social insurance programs and is relevant to the concerns of users who are assessing options for dealing with those challenges. The number not only draws attention to the challenge but also quantifies it in a way that can support further analysis and decision-making. Federal accounting and financial reporting attempt to address the needs of users and to inform them for their decisions, including decisions on these highly important and topical issues.

98. For example, the 1994-96 Advisory Council on Social Security expressed interest in three different approaches to restoring financial solvency and improving the rate of return on individual's contributions to the Social Security System. The three plans were entitled "Maintenance of Benefits," "Individual Accounts," and "Personal Security Accounts (PSA)." The PSA plan involved transition costs that the plan's advocates explained as follows:

Transition costs arise because, under the present system, there are large unfunded accrued obligations—that is, benefits scheduled to be paid to current retirees and to workers who have already paid taxes in excess of assets on hand. Under the plan, these obligations would be met as they mature. At the same time, the new fully-funded component of the system would be implemented. During the phase-in of the new system, the cost of meeting obligations under the existing system is sometimes referred to as the "transition cost."

Transition costs would be met with a combination of added taxes and added Federal borrowing. The SSA [Social Security Administration] actuaries project that a 1.52 percent supplement to the payroll tax would cover average long-range transition costs over the next 72 years.¹⁷ However, because the unfunded accrued obligations under the existing system are highest in the next couple of decades and taper off in later decades, there is a shortfall of revenues between about 2000 and 2034 and an excess of revenues thereafter. It is assumed that the shortfall would be met by issuing bonds to the public for the next 40 years (totaling an estimated \$1.9 trillion in 2034, in 1995 dollars), and that these bonds would be fully repaid by the excess of tax revenues in the later period. [vol. 1, p. 32]

99. Similarly, Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, has discussed the challenge confronting the Social Security system and the relevance of the transition amount:

¹⁷Note that this rate differs from the 2.17 percent increase in the payroll tax that has been estimated to be necessary to maintain benefits under current law; see p. 25 of the 1994-96 Advisory Council report, vol. 1.

... It has become conventional wisdom that the social security system, as currently constructed, will not be fully viable after the baby boom generation starts to retire.... This imbalance in social security stems primarily from the fact that, until very recently, payments into the social security trust accounts by the average employee, plus employer contributions and interest earned, were inadequate to fund the total of retirement benefits. This has started to change. Under the most recent revisions to the law and presumably conservative economic and demographic assumptions, today's younger workers will pay social security taxes over their working years that appear sufficient, on average, to fund their benefits during retirement. However, the huge liability for current retirees, as well as for much of the work force closer to retirement, leaves the system as a whole badly underfunded.¹⁸

100. In the course of discussing a variety of economic issues and policy options (including “privatization”) that transcend accounting, Mr. Greenspan continues:

Any move toward privatization will confront the problem of how to finance previously promised benefits. That would presumably involve making the implicit accrued unfunded liability of the current social security system to beneficiaries explicit.... If markets perceive that this liability has the same status as explicit federal debt, then one must presume that interest rates have already fully adjusted to the implicit contingent liability. However, if markets have not fully accounted for this implicit liability, then making it explicit could lead to higher interest rates for U.S. government debt.... There is reason to suspect, however, that if such a liability is made explicit in a manner similar to the transition procedure in Chile, each dollar of new liability will weigh far less on financial markets than a dollar of current public debt.¹⁹

101. Mr. Greenspan mentioned some reasons why the capital market’s reaction—though possibly substantial—might be muted if the government made this implicit liability more explicit. The Federal Reserve has estimated that, using a 2 percent real rate of discount and other assumptions, the value of all currently accrued legislated future Social Security retirement benefits would be roughly \$9.5 trillion.
102. The assumptions, benefits, population, and actuarial approach covered by this estimate differ somewhat from those used by the Social Security Trustees in the past to produce the closed group estimate comparable to the one called for by this statement. The calculation used for Mr. Greenspan’s testimony is an estimate of the

¹⁸Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Task Force on Social Security, Committee on the Budget, United States Senate, Nov. 20, 1997, p. 1.

¹⁹Greenspan, p. 4-5.

actuarial present value of future benefits arising from individuals' covered employment to the date of calculation, without considering their expected future employment until they retire. The estimate for the closed group in this standard considers both benefits to be earned and contributions to be made for current participants, in addition to benefits already earned or credited. Also, Mr. Greenspan's estimate is for Old-Age and Survivors Insurance only while this standard proposes that the closed group estimate for Social Security also include Disability Insurance. However, the numbers are roughly comparable.

103. The Chairman concluded by saying

We owe it to those who will retire after the turn of the century to be given sufficient advance notice to make what alterations in retirement planning may be required. If we procrastinate too long, the adjustments could be truly wrenching. Our senior citizens, both current and future, deserve better.²⁰

...

Money's Worth

104. The Board considered requiring a "money's worth" measure. Such a measure would show all contributions paid and benefits received by different age groups (e.g., those born in 1920 compared with 1940). The 1994-96 Advisory Council on Social Security recommended that Social Security meet a test of providing a reasonable money's worth return on the contributions of younger workers and future generations, while taking into account the redistributive nature of the system. The Council said that, although money's worth return was only one measure among many, it was important to the long-range sustainability of the program for younger generations to believe that they were getting a reasonable return on their taxes. The Council said,

Social Security should provide benefits to each generation of workers that bear a reasonable relationship to total taxes paid, plus interest.

Many important values served by a Social Security system are not fully captured by looking solely at money's worth or rates of return. Nevertheless, the Council believes that it is important that young workers perceive that the system is fair. This perception suggests that the younger generation should be well treated in terms of the issue of money's worth, taking into account the fact that within each generation there will be a redistribution toward the lower paid. [vol. 1, p. 17]

²⁰Greenspan, p. 9.

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105. Some argue that the money's worth measure may be viewed as a good measure of potential future stress caused by the disparity between taxes and anticipated benefits. However, others argue that this measure is of questionable relevance given the basic design and breadth of the benefits available under some social insurance programs. For example, the Social Security benefit formula is designed to provide relatively higher benefits for workers with lower earnings. This feature of the program is inconsistent with a pure focus on money's worth. Finally, as commonly reported, this measure does not reflect some social insurance programs and program features such as benefits to the disabled or dependents in the event of the participant's death.
106. The Board considered the money's worth measure and believes that it presents a useful perspective. However, the Board decided not to require it because it fails to capture the complexity of social insurance programs and could be calculated from too many perspectives. The Board recognizes the usefulness of the measure for policy analysis (and management may wish to report it voluntarily) but it goes beyond what the Board regards as essential to present fairly the financial position, condition, and results of operations of the reporting entities involved (including the governmentwide entity). Accordingly, the Board decided not to require RSSI about money's worth.

Trust Fund Ratio

107. The Board also considered the "trust fund ratio" which is defined as the fund balance at the beginning of the year expressed as a percentage of the outgo during the year; or, in other words, the proportion of a year's outgo that could be paid with the funds available at the beginning of the year.²¹ The trust fund ratio is one of several measures the Social Security trustees use to evaluate the short-term financial status of the trust funds. Also, the 1994-96 Social Security Advisory Council advocated using the trust fund ratio as a gauge of long-term sustainability. The Council recommended that, in addition to the actuarial balance over 75 years, the program should have a stable trust fund ratio over the final years of the 75-year forecast horizon.²² The Council believed that the trend of trust fund ratio would indicate

²¹The 1997 Annual Report of The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 221.

²²See *Findings and Recommendations*, vol. 1, p. 17 (Jan. 1997).

whether there would be cause for concern about the years beyond the 75-year horizon. The Council was concerned that all factors known at the time of the 75-year projection be considered and reported, including whether there were problems beyond the 75-year projection period. For example, even as the trustees are reporting that the system is in actuarial balance over 75 years, demographic trends could make the next 10 years beyond the 75-year horizon more expensive.

108. The Board decided not to recommend the trust fund ratio as RSSI for a number of reasons. In particular, to be useful, the ratio would have to be used in conjunction with a projection that was in actuarial balance or nearly so. Under the current “best estimate” projection, where fund balance is expected to be exhausted well before 75 years, the trust fund ratio would not be usable. Although the Board acknowledges that the ratio may be useful as an indicator of short-term financial condition, it believes the projections and estimates in this standard will be more informative for accounting purposes.

...

Component &
Governmentwide
Perspectives

109. In developing these standards, the Board attempted to address the component entity as well as governmentwide reporting. From the perspective of the component federal entity, the accounting and reporting includes assets in the form of Treasury securities as well as interest thereon. These are not claims on third parties. The assets of the funds are offset by an identical liability of the U.S. Treasury. Like other intragovernmental assets and liabilities, they do not represent assets (or liabilities) of the Federal Government as a whole and are eliminated for governmentwide reporting. The nonmarketable Treasury debt securities are evidence of the accumulation of excess cash receipts over cash disbursements within the social insurance program.

Appendix B - Sample Reporting For Illustration Only

NOTE

The sample report sections in Appendix B provide nonauthoritative illustrations of possible RSSI that would comply with this standard. The narrative, charts, tables, and other information shown there are intended to be one approach among others to provide a full description of the programs and to supply the required information. The standard does not require any particular format or graph. Most, but not all, of the data presented in Appendix B would be required by pars. 27 and 32 of the standard (e.g., the year the fund balance is exhausted [see par. 117] and the open group actuarial deficit as a percentage of taxable payroll [see par. 120] would not be required). This is done to illustrate that management may provide more supplementary information than is required by the standard.

Most data are taken from various reports for FY 1996 and are “actual data.” Certain data are hypothetical. Although the data are realistic, readers should not rely on the validity of the data in the sample reports.

OMB provides specific form and content guidance on financial reports.

Social Security - Required Supplementary Stewardship Information

Statement of Social Insurance - Old-Age, Survivors and Disability Insurance - 75-Year Projection^a as of September 30, 1996 [HYPOTHETICAL DATA]

Dollars in Trillions

	Prior Years				
	1996	1995	1994	1993	1992
<i>Actuarial present value of future benefit payments^b during the 75-year period to or on behalf of:</i>					
Current participants not yet having attained retirement age ^c	\$ X	\$ X	\$ X	\$ X	\$ X
Current participants who have attained retirement age ^c	X	X	X	X	X
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
Subtotal—benefit payments for the 75-year period	19	X	X	X	X
<i>Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:</i>					
Current participants not yet having attained retirement age	Y	Y	Y	Y	Y
Current participants who have attained retirement age ^c	Y	Y	Y	Y	Y
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y
Subtotal—contributions and tax income for the 75-year period	16	Y	Y	Y	Y
<i>Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period^d</i>	\$ 3	\$ X	\$ X	\$ X	\$ Y

Notes to the Statement:

^aThe projection period for new entrants covers the next 75 years. The projection period for current participants (or “closed group”) would theoretically cover all of their working and retirement years, a period that could be greater than 75 years in a few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

^b“Benefit payments” include administrative expenses.

^cTo calculate the actuarial net present value of the excess of future benefit payments to current participants (that is, to the “closed group” of participants) over future contributions and tax income from them or on their behalf, subtract the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

^dThe calculation of the “close actuarial balance” used for analysis by the Social Security trustees differs from the calculation of the amount presented on this line. The trustees’ close actuarial balance calculation includes the fund balance at the beginning of the period as an item of cash inflow and the cost of about one year’s expenditure, as a target fund balance at the end of the period, as a cash outflow. The fund balance—which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over cash outflow within the social insurance program—for 1996 for the OASDI program is \$.6 trillion (OASI, \$.5 trillion, and DI \$.1 trillion). The fund balances for 1995-2, in trillions, were \$.6, .5, .5, .4, respectively. The fund balance consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

Program Description

110. The Old-Age, Survivors, and Disability Insurance (OASDI) program, collectively referred to as “Social Security” or OASDI, provides cash benefits for eligible U.S. citizens and residents. During calendar year 1996, OASDI provided benefits to approximately 44 million beneficiaries. Eligibility and benefit amounts are determined under the

laws applicable for the period. Current law provides that the amount of the monthly benefit payments for individuals, or dependent spouses and children, is based on the individuals' taxable earnings up to the date when payments commence.

111. The amount of the effective monthly OASDI benefits may be altered by changes in laws governing the program. In 1983 for example, up to one-half of OASDI benefits became taxable; cost-of-living-adjustments (COLAs) were permanently delayed six months; and the age for full retirement benefits was gradually increased from 65 to 67 over a 24-year period.

112. OASDI has been described as an income transfer program—that is, a program designed to reduce economic disparity by redistributing income between households. OASDI transfers income in at least two ways. First, its benefit structure is progressive in the sense that benefits during retirement for lower-income workers replace a larger proportion of income earned during their working years than is the case for higher-income workers. This results in an income transfer among workers of the same age group but in different income groups. Second, OASDI is financed largely on a pay-as-you-go basis. The payroll taxes paid to OASDI each year by current workers are primarily used to pay the benefits provided during that year to current beneficiaries. This results in income transfers between current workers and current beneficiaries and therefore between younger workers and older retirees, the disabled, and surviving family members.

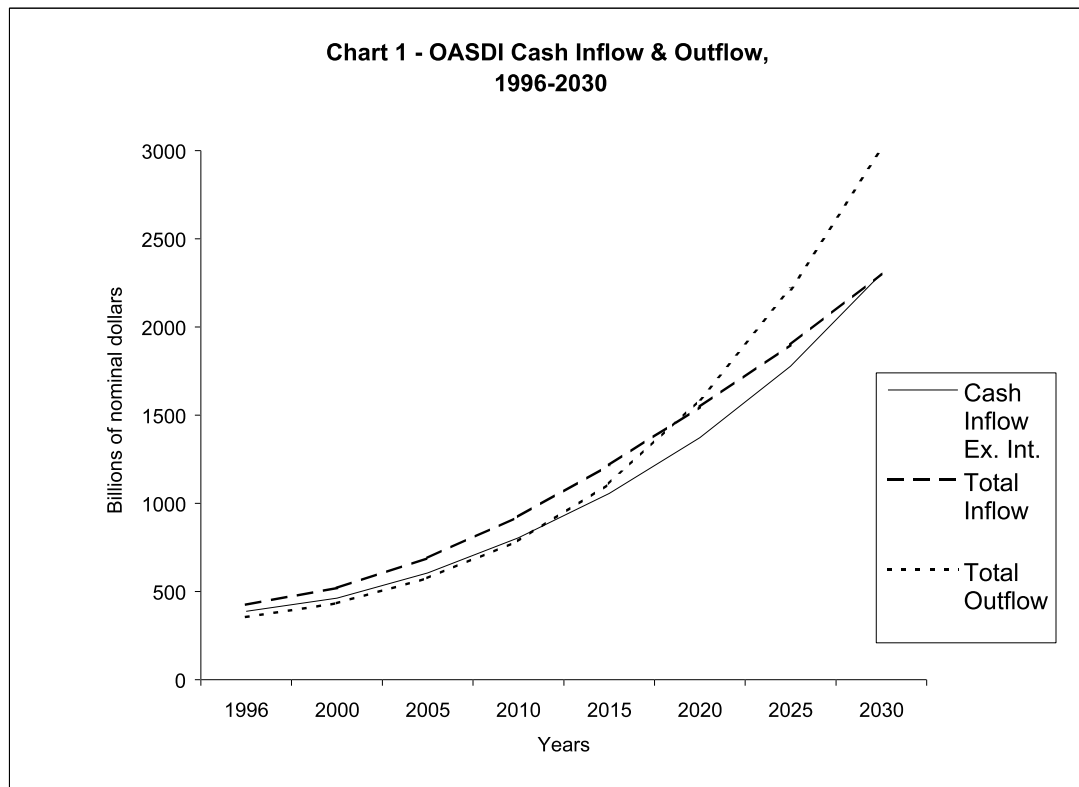
Program Finances and Sustainability

113. As discussed in Note X to the consolidated financial statements, a liability of \$34 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of OASDI benefits due to recipients for periods ended on or before September 30, 1996 (\$33 billion in FY 1995). Virtually all of this amount was paid in October 1996. Also, an asset is recognized for the "investments in Treasury securities" as of September 30, 1996, of \$550 billion (\$483 billion in FY 1995). This investment represents trust fund assets accumulated from the excess of payroll taxes over benefits in prior periods. This fund balance is available for OASDI's use in future periods when a deficit occurs in the program. These investments are referred to as "trust fund assets" throughout the remainder of this disclosure.

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114. No liability has been recognized on the balance sheet for future payments to be made to present and future program participants, beyond the unpaid amounts as of September 30, 1996. This is because the OASDI is accounted for as a social insurance program rather than a pension program. Accounting for a social insurance program recognizes the expense of benefits when they are actually paid or are due to be paid because benefit payments are primarily nonexchange transactions and are not considered deferred compensation as would employer-sponsored, employee's pension benefits. Accrual accounting for a pension program, by contrast, would recognize the retirement benefit expenses as they are earned during a worker's career so that the full actuarial present value of the expected retirement benefits has been recognized by the time the worker retires.
115. ***Supplementary Stewardship Information*** - While no liability has been recognized on the balance sheet for future payments beyond those due at period end, actuarial estimates of future program activities are made annually to assess the financial condition and prospects for OASDI and are presented here as supplementary stewardship information. The statement presented above and the displays below represent the best estimate of future cash inflow and outflow based on the assumptions shown at the end of this section and considering future changes previously mandated by law. However, estimates extending so far into the future are inherently uncertain, and the uncertainty is greater for the later years in the period. This stewardship information includes:
- (1) actuarial present values of future benefits for and contributions and tax income from or on behalf of current and future program participants;
 - (2) cashflow in **nominal dollars** and as percentages of taxable payroll and the GDP;
 - (3) the ratio of contributors to beneficiaries or "dependency ratio" showing the long-range relationship between the program's beneficiaries and contributors; and
 - (4) an analysis of the sensitivity of the projections to changes in assumptions.

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116. *Cashflow Projections* - Chart 1 below shows the actuarial estimate of OASDI cash inflow and outflow for each of the next 35 years, in nominal dollars, using data from the OASDI Trustees' annual report. The estimate is based on what the Trustees refer to as the **open group population** (i.e., all persons who will participate in the program as contributors or beneficiaries or both over the next 35 years). Thus, it includes payments from, and on behalf of, employees who will enter the workforce during the next 35 years as well as those now in the workforce.
117. As chart 1 shows, present estimates indicate that, in nominal dollars, cash outflow would start to exceed total inflow (including interest on intragovernmental borrowing/lending) in about 2019. This deficiency would continue at an increasing rate thereafter, require the redemption of investments in Treasury securities held as assets by the trust fund, and result in the exhaustion of accumulated asset balances in 2029.²³ Even before 2019, outflow would exceed cash inflow from the public (i.e., excluding interest paid by Treasury). Estimates indicate this will happen in about 2012, as shown in chart 1. From about 2012 forward, OASDI would pay more to the public than it would receive in taxes. This would increase the government's financing needs. Compared to a situation in which OASDI taxes equaled outgo, the government would have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.

²³[Please note: the standard does not require information on the year when the assets would be exhausted as the program is currently structured (see par. 117). This information illustrates that management can provide data in addition to that required by the standard where it feels doing so would be useful to readers of the report.]



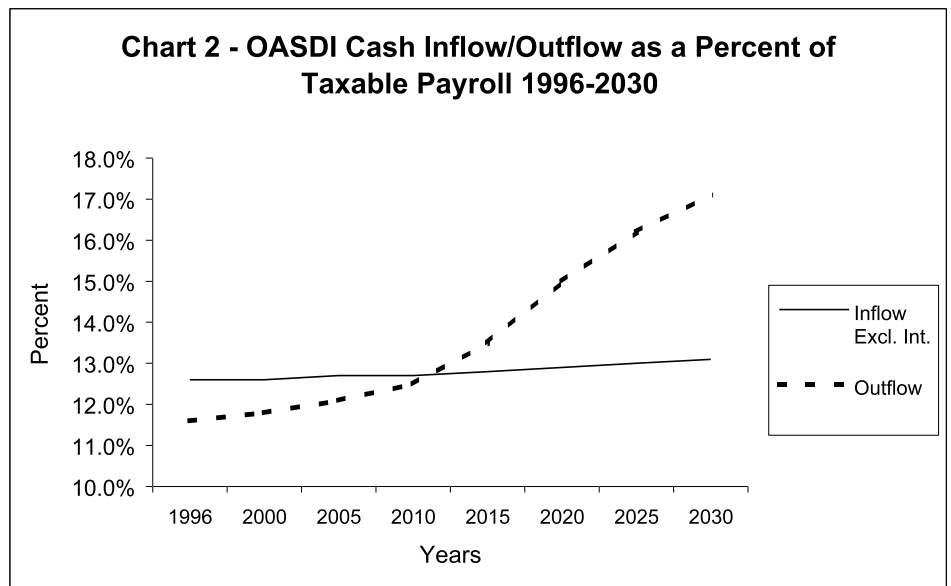
Source: Data from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Terms Used In Chart 1

The following terms are used in chart 1:

- **total inflow** includes payroll taxes, income tax on certain OASDI benefits, interest income, and miscellaneous reimbursement from the general fund;
- **cash inflow excluding interest** is income exclusive of interest on trust fund assets;
- **total outflow** includes benefit payments, administrative expenses, net transfers to the Railroad Retirement program, and vocational rehabilitation expenses for disabled beneficiaries.

118. *Percentage of Taxable Payroll* - The excess of cash outflow over inflow is due to a variety of factors including the retirement of the “baby boom” generation and the relatively small number of people born during the subsequent period of low birth rate. As presently constructed, the program receives most of its cash inflow from the 6.2 percent payroll tax that employees and employers each pay, for a total of 12.4 percent of taxable payroll. Chart 2 below illustrates the rising annual cost of the program relative to its annual income as a percentage of taxable payroll.



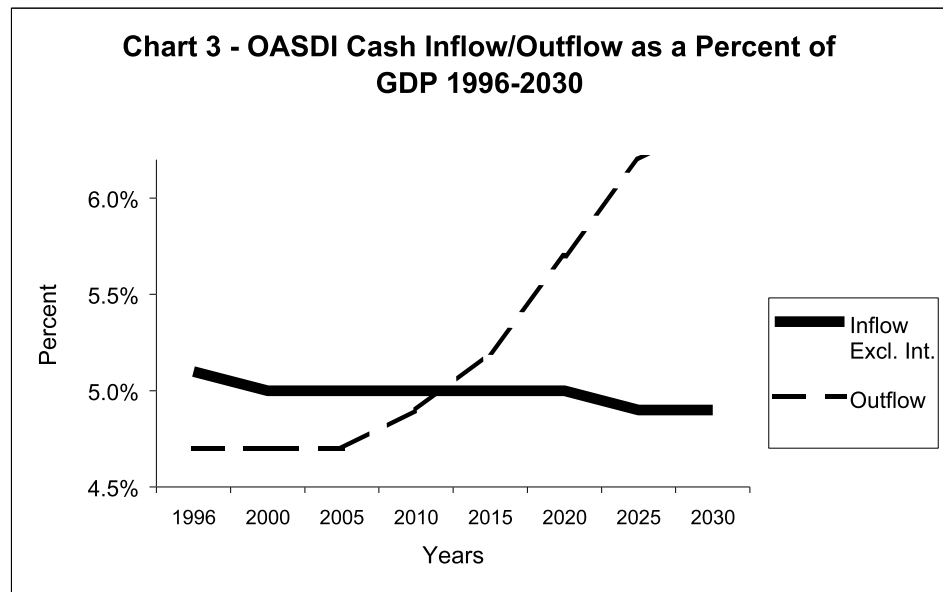
Source: Data from Tables III A2, 1996 OASDI Trustee's Report.

119. The total excess of cash outflow over inflow for OASDI over the next 75 years is estimated to be 2.17 percent of taxable payroll; in other words, a tax increase today of about 1.09 percent of taxable payroll each on employees and employers, over the 6.2 percent they each now pay, would produce enough inflow over 75 years to pay all benefits due under current law.²⁴ There would be trust fund surpluses in the early

²⁴[Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 2.]

years of the projection from which the Trustees would acquire Treasury securities to be used to pay benefits later.

120. Stated in terms of actuarial present value, the 2.17 percent deficit equates to an excess of expenditures over contributions of about \$3 trillion over the next 75 years from September 30, 1996. The accumulation and subsequent redemption of substantial trust fund assets have economic and public policy implications that go beyond the operation of the OASDI program itself. Discussion of these broader issues is not within the scope of this report.
121. *Percentage of GDP* - In addition to analyzing OASDI operations as a percentage of taxable payroll, viewing them as a percentage of the Gross Domestic Product (GDP) provides an additional perspective on these funds in relation to the capacity of the national economy to sustain them. The GDP represents the total value of goods and services produced in the United States. Chart 3 below shows OASDI's cost as a percentage of GDP.

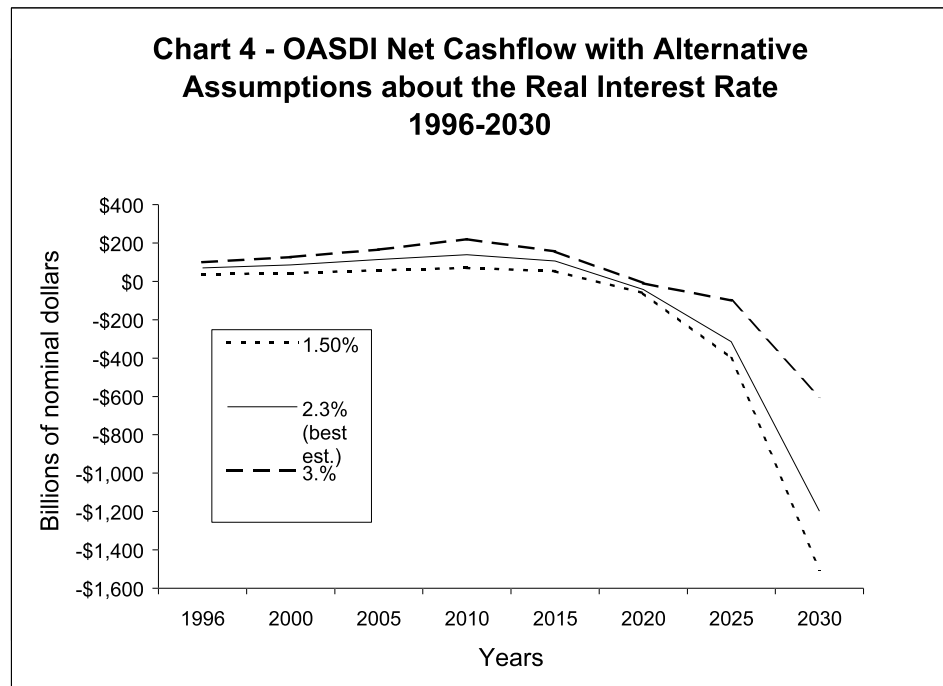


Source: Data from Tables III C1, 1996 OASDI Trustee's Report.

122. In 1996, federal spending for OASDI exceeded \$350 billion, which was about 4.7 percent of GDP. By 2030, when most baby boomers will have retired, the program (based on current law) will consume nearly

50 percent more of GDP than it does today—6.4 percent. Nearly all of the increase between now and 2030 will occur between 2010 and 2030, as retired baby boomers become eligible for those programs.

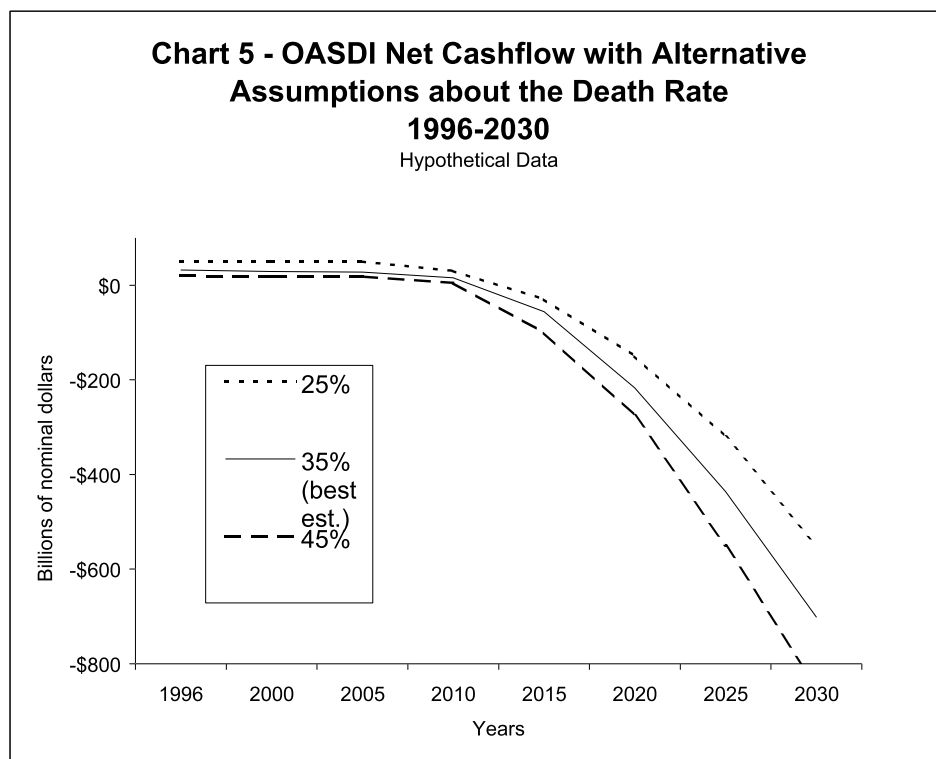
123. ***Sensitivity Analysis*** - As indicated by the assumptions shown at the end of this section, the future cashflow of the OASDI program depends on many economic and demographic assumptions, including GDP, labor factors, unemployment, average wages and self-employment earnings, interest rates on Treasury securities, productivity, inflation, fertility, mortality, net immigration, marriage, divorce, retirement patterns, and disability incidence and termination. The cash inflow will depend on how these factors affect the size and composition of the working population and the level and distribution of wages and earnings. Similarly, the outgo will depend on how these factors affect the size and composition of the beneficiary population and the general level of benefits. Precise long-range projections of these factors is impossible.
124. This section illustrates the sensitivity of the long-range projections to changes in assumptions by analyzing five key individual assumptions: the real interest rate, the death and birth rates, net immigration, and the real wage differential. For this analysis the “best estimate” cost assumptions are used as the reference point, and each assumption is varied within it individually.
125. ***Real Interest Rate*** - The “best estimate” long-range cashflow projections presented in Chart 1 above assume a 4 percent increase in Consumer Price Index (CPI) per year after the year 2000 as the inflation rate and a 2.3 percent real interest rate. The “real interest rate” is the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the CPI. Chart 4 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 2.3 percent real interest rate, with the net cashflow that would result from decreasing the real interest rate to 1.5 percent and increasing it to 3 percent.



Source: Data regarding “best estimate” is from Tables III B1, B3, & C1, 1996 OASDI Trustee’s Report

As stated above, the estimated total excess of OASDI cash outflow over cash inflow over the next 75 years is \$3 trillion. If the annual real interest rate—that is, the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the Consumer Price Index (CPI)—is changed from the 2.3 percent used for the best estimate projection to 1.5 percent, the total excess of cash outflow would increase to \$3.8 trillion; if the rate were changed to 3 percent, the total excess would decrease to \$2.5 trillion.

126. *Death Rate* - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during 1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.

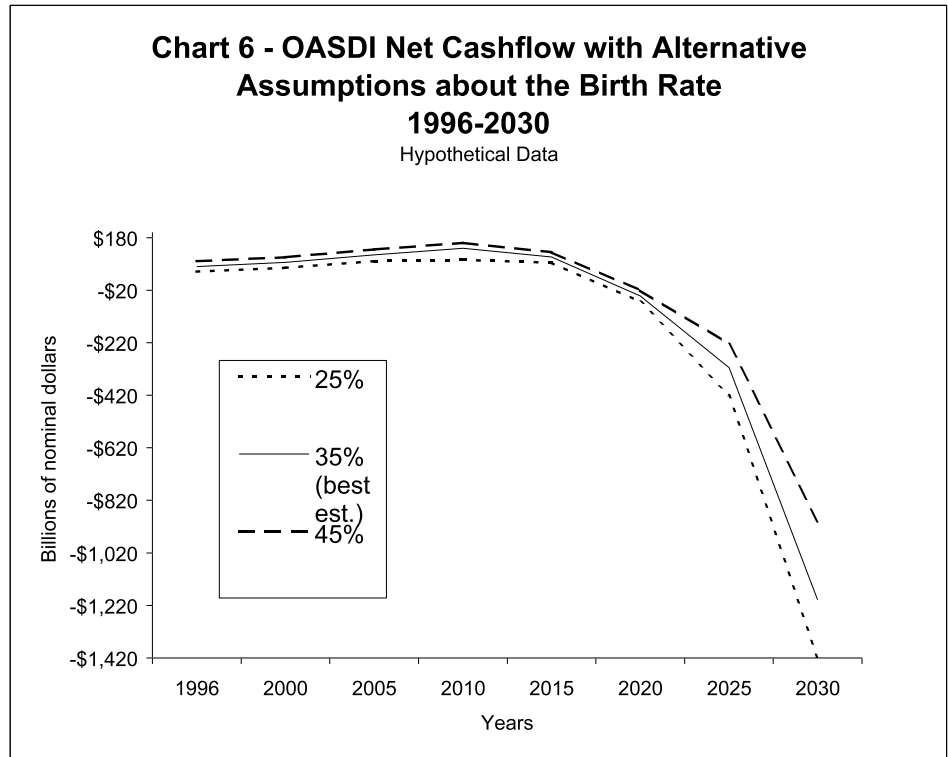


Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Regarding actuarial present values for a 75-year projection period, if the decrease in the death rate is changed from the 35 percent used for the best estimate projection to 15 percent, meaning that more people are dying, the total excess of cash outflow for the period would decrease to \$2.1 trillion, from \$3.0 trillion; if the rate were changed to 55 percent, the total excess cash outflow would increase to \$4.2 trillion.

127. *Birth Rate* - Table 1 below shows the estimated total excess OASDI cash outflow over inflow over a 75 year projection period using a birth rate above and below the rate used for the best estimate projection. This analysis was developed by varying the percentage increase in the birth rate assumed to occur during 1996-2070. The rate used for the best estimate projection assumes a ultimate birth rate in 2070 of 1.9 children per woman. Chart 6 below shows the estimated OASDI cash inflow and outflow using a birth rate above and below the rate

used for the projection in Chart 1 above. Chart 6 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1.9 birth rate, with the net cash outflow that would result from decreasing the rate to 1.6 percent and increasing it to 2.2 percent.



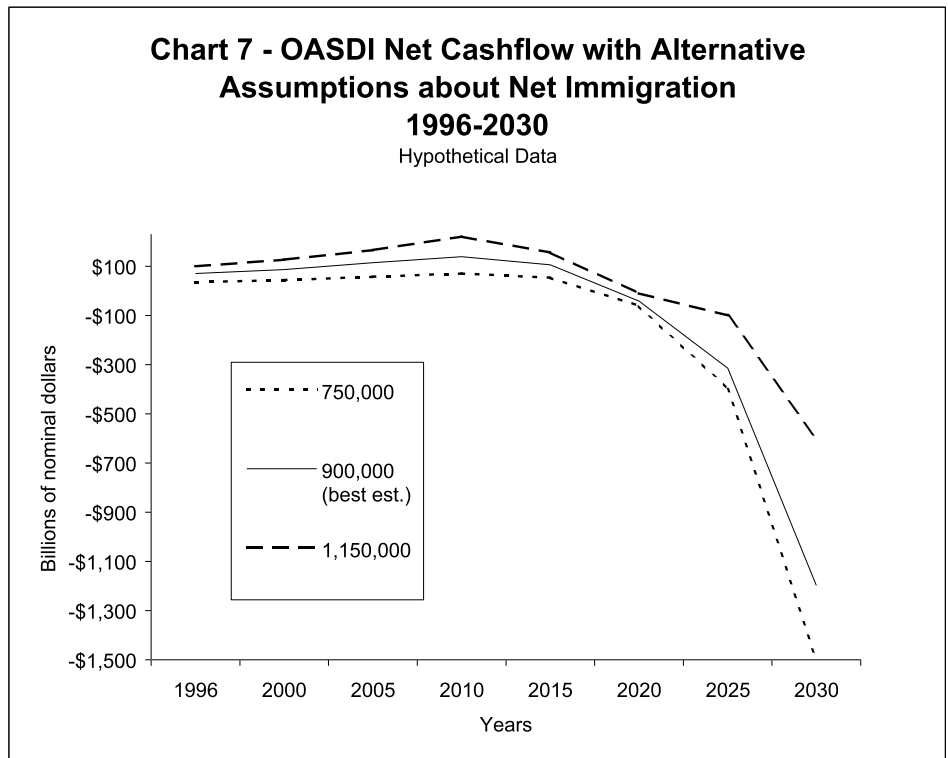
Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Table 1 presents the affect of using rates of 1.6 and 2.2 on the excess of cash outflow over inflow during the projection period. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions - Valuation Period: 1996-2070

Valuation Period: 1996-2070	Ultimate Birth Rate Per Woman		
	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	\$3.7	\$3.0	\$2.5

128. *Net Immigration*—Chart 7 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 900,000 per year net immigration rate, with the net cashflow that would result from decreasing the rate to 750,000 and increasing it to 1,150,000.



Source: Data regarding “best estimate” from Tables III B1, B3, & C1, 1996 OASDI Trustee’s Report.

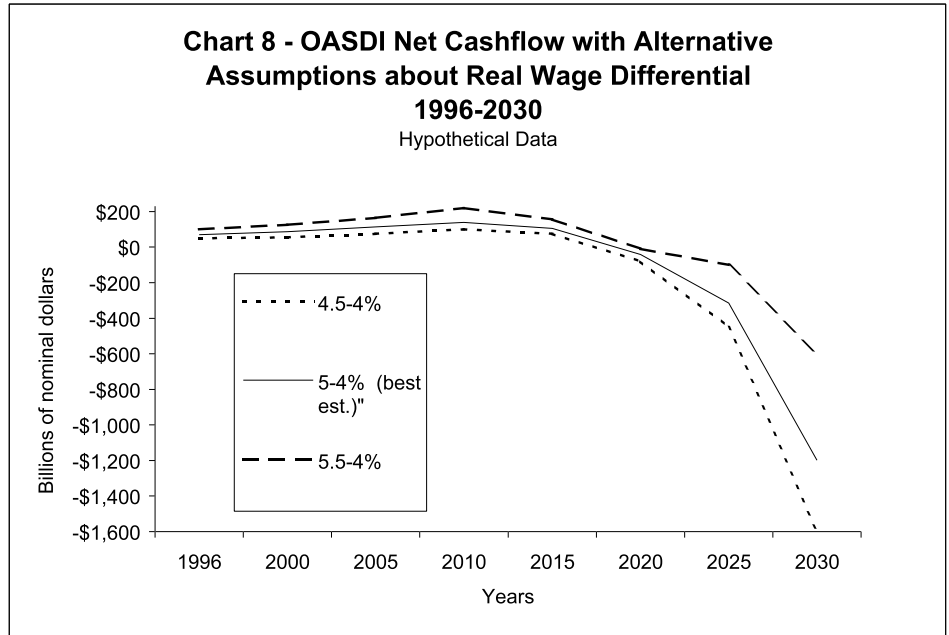
Regarding actuarial present values over 75 years, table 2 below shows the estimated total excess of OASDI cash outflow over inflow with assumptions that differ from those used for the “best estimate” projection.

Table 2: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Net Immigration Assumptions - Valuation Period: 1996-2070

Dollars in trillions

Valuation Period: 1996-2070	Net immigration per year		
	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over cash inflow	\$3.2	\$3.0	\$2.9

129. *Real-Wage Differential* - Chart 8 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1 percent real wage differential, with the net cashflow that would result from decreasing the rate to .5 percent and increasing it to 1.5 percent. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI.

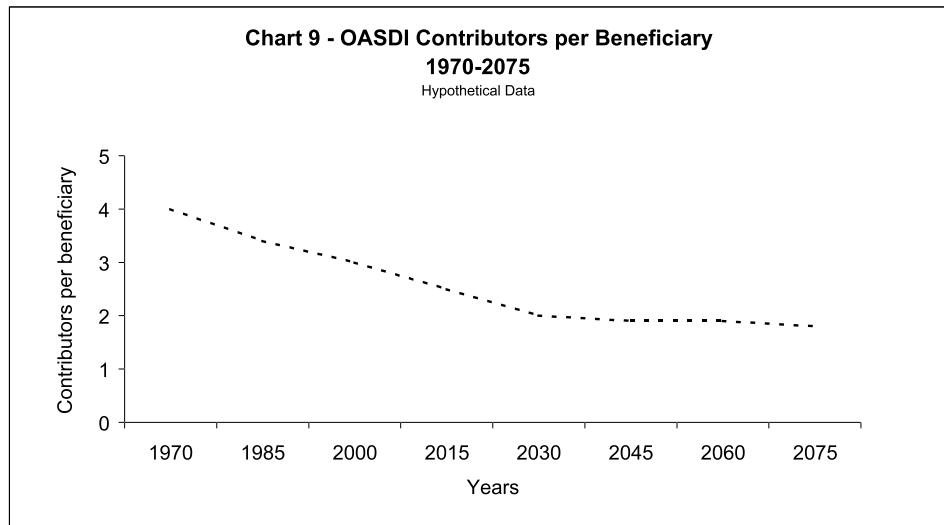


Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Regarding actuarial present values over 75 years, table 3 below shows the estimated total excess of OASDI cash outflow over inflow with various assumptions about the real-wage differential.

Table 3- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Real-Wage Assumptions - Valuation Period: 1996-2070			
Dollars in trillions			
Wages-CPI	Ultimate percentage in wages-CPI		
	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Excess cash outflow over inflow	\$3.9	\$3.0	\$2.3

130. ***Dependency Ratio*** - Chart 9 below shows the estimated number of covered workers per OASDI beneficiary using the Trustees' best estimate. As defined by the Trustees, covered workers are persons having earnings creditable for OASDI purposes on the basis of services for wages in covered employment and/or on the basis of receipts from covered self-employment. As Chart 6 shows, the number of workers to beneficiaries will decline from 3.3 per beneficiary in 1995 to 2 per beneficiary in 2030 and 1.8 in 2075.



Social Security Assumptions-

Assumptions Used

The estimates used in this presentation are based on the assumption that the programs will continue as presently constructed. They give effect to certain additional economic and demographic assumptions, including those in the following table:

	Average Annual Percent Change			Ave. Annl. Interest Rate on Treasury Secur. (%)	Ave. Annl. Unempl. Rate	Ave. no. of children per woman	Death rate per 100,000	Life expectancy	
	GDP	Wages	CPI					Men	Women
1996	2.0	4.0	2.0	6.0	5.0	2.0	757	72	79
2000	2.0	4.3	3.5	6.5	6.0	2.0	731	73	79
2005	2.0	5.1	4.0	6.4	6.0	2.0	700	73	80
2010	1.8	5.0	4.0	6.3	6.0	2.0	677	74	80
2020	1.3	5.1	4.0	6.3	6.0	1.9	638	75	81
2030	1.4	5.0	4.0	6.3	6.0	1.9	603	76	81

These assumptions and the other values on which these displays are based represent the latest and most likely — or “best” — estimates of these values by the Trustees. Estimates made in certain prior years have changed substantially because of revisions to the assumptions due to changed conditions or experience, and to changes in actuarial methodology. It is reasonable to expect more changes for similar reasons in the future.

Unemployment Insurance Programs

131. The U. S. Department of Labor operates two programs classified under federal accounting standards as social insurance, the Unemployment Insurance Program and the Black Lung Disability Benefits Program. Presented below is the required supplementary stewardship information for the Unemployment Insurance Program.

Program Description

132. The Unemployment Insurance (UI) program was created in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. The program protects workers during temporary periods of unemployment, through the provision of unemployment compensation benefits. These benefits replace part of the unemployed worker’s lost wages and, in so doing, stabilize the economy during recessionals periods by increasing the unemployed worker’s lost wages and purchasing power. The UI program operates counter cyclically, paying benefits during recessionary periods and collecting UI tax revenue during periods of recovery.

133. ***Program Administration and Funding*** - The UI program is administered through a unique system of federal-state partnerships,

established in federal law but executed through conforming state laws by state officials. The Federal Government provides broad policy guidance and program direction through the oversight of the U.S. Department of Labor, while program details are established through individual state UI statutes, administered through state UI agencies.

134. ***Federal and State Unemployment Taxes*** - The UI program is financed through the collection of federal and state unemployment taxes levied on subject employers and deposited in the unemployment trust fund (UTF). Federal unemployment taxes are used to pay for the administrative costs of the UI program, including grants to each state to cover the costs of state UI operations, as well as the federal share of extended UI benefits. Federal unemployment taxes are also used to maintain a loan account within the UTF, from which insolvent state accounts may borrow funds to pay UI benefits. State UI taxes are used exclusively for the payment of regular UI benefits, and the state's share of extended benefits. These taxes and the UTF established to account for their receipt, investment, and disbursement are discussed below.
135. *Federal Unemployment Taxes* - Under the provisions of the Federal Unemployment Tax Act (FUTA), a federal tax is levied on covered employers, at a current rate of 6.2 percent of the first \$7,000 in annual wages paid to each employee. This federal tax is reduced by a credit of up to 5.4 percent granted to employers paying state UI taxes under conforming state UI statutes. Accordingly, in conforming states, employers pay an effective federal tax of .8 percent. Federal unemployment taxes are collected by the Internal Revenue Service.
136. *State Unemployment Taxes* - In addition to the federal tax, individual states finance their UI programs through state tax contributions from subject employers on the wages of covered employees. (Three states also collect contributions from employees.) Within Federal confines, state tax rates are assigned in accordance with an employer's experience with unemployment. Actual tax rates vary greatly among the states and among individual employers within the state. At a minimum, these rates must be applied to the federal tax base of \$7,000; however, states may adopt a higher wage base than the minimum established by FUTA. State UI agencies are responsible for the collection of state unemployment taxes.

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137. ***Unemployment Trust Fund*** - Federal and state UI taxes are deposited into designated accounts within the UTF. The UTF was established under the authority of Title IX, section 904 of the Social Security Act of 1935, as amended, to receive, hold, invest, loan, and disburse federal and state UI taxes. The U.S. Department of the Treasury invests amounts in excess of disbursing requirements in Treasury securities. The UTF is comprised of the following accounts:
138. *Federal Accounts* - The Employment Security Administration Account (ESAA) was established pursuant to section 901 of the Social Security Act. All tax receipts collected under the FUTA are appropriated to the ESAA and used to pay the costs of federal and state administration of the UI program and veterans employment services, as well as 97 percent of the costs of the state employment services. Excess balances in ESAA, as defined under the act, are transferred to other federal accounts within the fund, as described below.
139. The Federal Unemployment Account (FUA) was established pursuant to section 904 of the Social Security Act. FUA is funded by any excesses from the ESAA as determined in accordance with section 902 of the act. Title XII, section 1201 of the act authorizes the FUA to loan federal monies to state accounts that are unable to make benefit payments because the state UI account balance has been exhausted. Title XII loans must be paid with interest. The FUA may borrow from the ESAA or the Extended Unemployment Compensation Account (EUCA), without interest, or may also receive repayable advances, with interest, from the general fund of the U.S. Treasury when the FUA has a balance insufficient to make advances to the states.
140. The Extended Unemployment Compensation Account (EUCA) was established pursuant to section 905 of the Social Security Act. EUCA provides for the payment of extended unemployment benefits authorized under the federal/state Extended Unemployment Compensation Act of 1970, as amended. Under the extended benefits program, extended unemployment benefits are paid to individuals who have exhausted their regular unemployment benefits. These extended benefits are financed one-half by state unemployment taxes and one-half by FUTA taxes obtained from the EUCA. The EUCA is funded by a percentage of the FUTA tax transferred from the ESAA in accordance with section 905(b)(1) and (2) of the Social Security Act. The EUCA may borrow from the ESAA or the FUA, without interest, or may also receive repayable advances from the general fund of the

Treasury when the EUCA has a balance insufficient to pay the federal share of extended benefits. During periods of sustained high unemployment, the EUCA may also receive payments and non repayable advances from the general fund of the Treasury to finance emergency unemployment compensation benefits. Emergency unemployment benefits require congressional authorization.

141. The Federal Employees Compensation Account (FECA) was established pursuant to section 909 of the Social Security Act. FECA provides funds to states for unemployment compensation benefits paid to eligible former federal civilian personnel and ex-service members. Generally, benefits paid are reimbursed to the FECA by the various federal agencies. Any additional resources necessary to ensure that the account can make the required payments to states, due to the timing of the benefit payments and subsequent reimbursements, will be provided by non repayable advances from the general fund of the Treasury.
142. *State Accounts* - Separate state accounts were established for each state and territory depositing monies into the UTF, in accordance with section 904 of the Social Security Act. State unemployment taxes are deposited into these individual accounts and may be used only to pay state unemployment benefits. States may receive repayable advances from the FUA when their balances in the UTF are insufficient to pay benefits.
143. *Railroad Retirement Accounts* - The Railroad UI Account and Railroad UI Administrative Account were established under section 904 of the Social Security Act to provide for a separate unemployment insurance program for railroad employees. This separate unemployment insurance program is administered by the Railroad Retirement Board, an agency independent of the Department of Labor (DOL). DOL is not responsible for the administrative oversight or solvency of the railroad unemployment insurance system. Receipts from taxes on railroad payrolls are deposited in the Railroad UI Account and the Railroad UI Administrative Account to meet benefit payment and related administrative expenses.
144. ***UI Program Benefits*** - The UI program provides regular and extended benefit payments to eligible unemployed workers. Regular UI program benefits are established under state law, payable for a period not to exceed a maximum duration. In 1970, federal law began

to require states to extend this maximum period of benefit duration by 50 percent, during periods of high unemployment. These extended benefit payments are paid equally from federal and state accounts.

145. *Regular UI Benefits* - There are no federal standards regarding eligibility, amount, or duration of regular UI benefits. Eligibility requirements, benefit amounts, and benefit duration are determined under state law. Under state laws, worker eligibility for benefits depends on experience in covered employment during a past base period, which attempts to measure the workers' recent attachment to the labor force. Three factors are common to state eligibility requirements: (1) a minimum duration of recent employment and earnings during a base period to unemployment, (2) unemployment not the fault of the unemployed, and (3) availability of the unemployed for work.
146. Benefit payment amounts under all state laws vary with the worker's base period wage history. Generally, states compute the amount of weekly UI benefits as a percent of an individual's average weekly base period earnings, within certain minimum and maximum limits. Most states set the duration of UI benefits by the amount of earnings an individual has received during the base period. Currently, all but two states have established the maximum duration for regular UI benefits at 26 weeks (Massachusetts and Washington state provide 30 weeks). Regular UI benefits are paid by the state UI agencies from monies drawn down from the state's account within the UTF.
147. *Extended UI Benefits* - The Federal/State Extended Unemployment Compensation Act of 1970 provides for the extension of the duration of UI benefits during periods of high unemployment. When the insured unemployment level within a state, or in some cases total unemployment, reaches certain specified levels, the state must extend benefit duration by 50 percent, up to a combined maximum of 39 weeks. Fifty percent of the cost of extended unemployment benefits is paid from the EUCA within the UTF, and 50 percent by the state, from the State's UTF account.
148. *Emergency UI Benefits* - During prolonged periods of high unemployment, Congress may authorize the payment of emergency unemployment benefits to supplement extended UI benefit payments. Emergency benefits were last authorized in 1991 under the EUCA. Emergency benefit payments in excess of \$28 billion were paid over

the three year period ending in 1994. Emergency benefits were paid from the surplus of federal unemployment taxes in EUCA and, once EUCA balances were exhausted, from general revenues of the U.S. Treasury.

149. *Federal UI Benefits* - Unemployment benefits to unemployed federal workers are paid from the FECA within UTF and then reimbursed by the responsible federal agency. They are not considered to be social insurance benefits. Federal unemployment compensation benefits are not included in this discussion of social insurance programs.

Program Finances and Sustainability

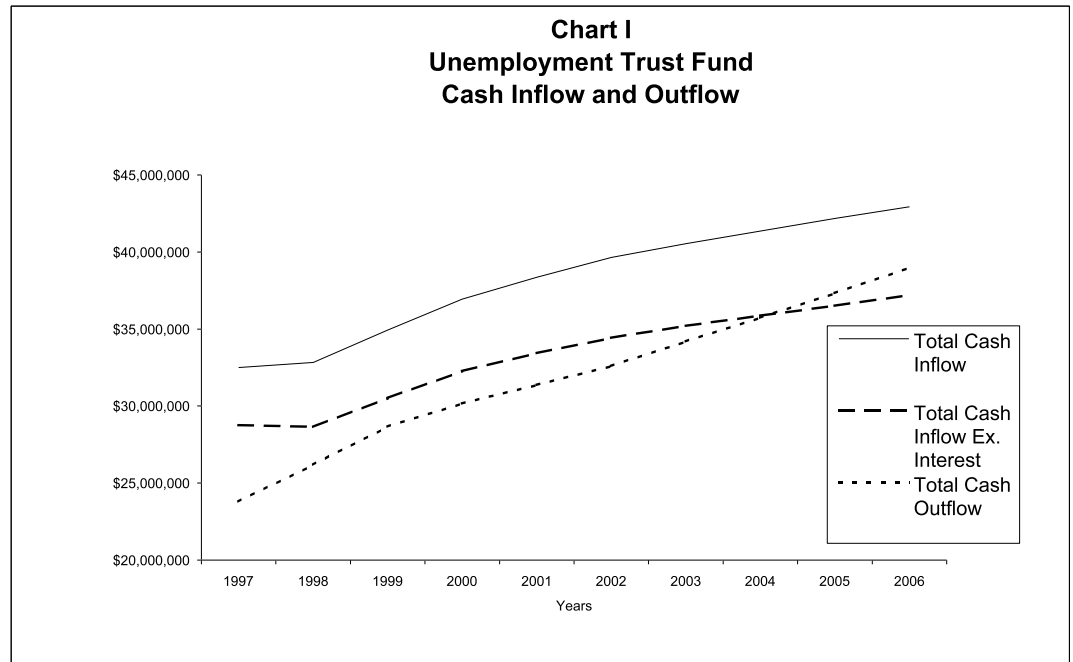
150. At September 30, 1996, total assets within the UTF exceeded liabilities by \$54.0 billion.²⁵ This fund balance approximates the accumulated surplus of tax revenues and earnings on these revenues over benefit payment expenses and is available to finance benefit payments in future periods when tax revenues may be insufficient. Treasury invests this accumulated surplus in federal securities. The net value of these securities at September 30, 1996, was \$53.9 billion. These investments accrue interest, which is distributed to eligible state and federal accounts within the UTF. Interest income from these investments during FY 1996 was \$3.4 billion. As discussed in Note 1.B.3 to the consolidated financial statements, DOL recognized a liability for regular and extended unemployment benefits to the extent of unpaid benefits applicable to the current period. Accrued unemployment benefits payable at September 30, 1996, were \$506.4 million.

151. ***Effect of Projected Cash Inflows and Outflows on the Accumulated Net Assets of the UTF*** - The ability of the UI programs to meet a participant's future benefit payment needs depends on the availability of accumulated taxes and earnings within the UTF. The DOL measures the effect of projected benefit payments on the accumulated net assets of the UTF, under an open group scenario, which includes current and future participants in the UI

²⁵[Please note: the standard does not require information on the total amount of securities held at the balance sheet date. This information illustrates that management can provide data in addition to that required by the standard when it feels doing so would be useful to readers of the report.]

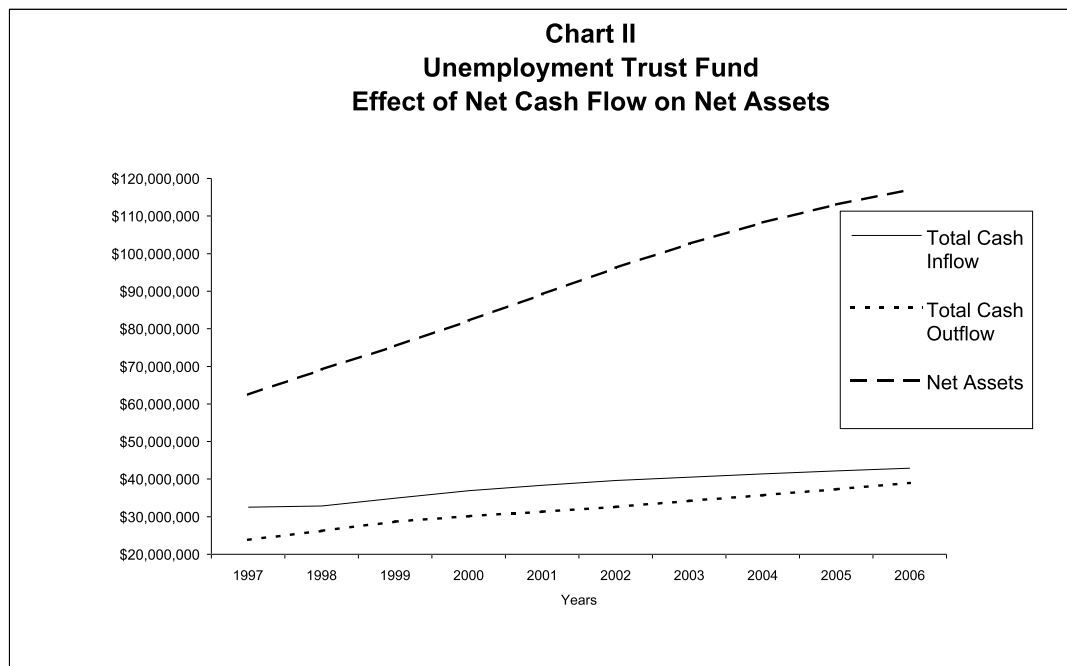
program. Future estimated cash inflows and outflows of the UTF are tracked by DOL for budgetary purposes. These projections allow the DOL to monitor the sensitivity of the UI program to differing economic conditions, and to predict the program's sustainability under varying economic assumptions. Charts I through IV graphically depict the effect of varying economic conditions on the UTF over the next 10 years.

152. *Projected Cash Inflows and Outflows Under Expected Economic Conditions* - Chart I depicts projected cash inflow and outflow of the UTF over the next 10 years, under expected economic conditions. Total cash inflow as well as cash inflow excluding interest earnings is displayed. DOL's current estimates were based on an expected unemployment rate of 5.1 percent during FY 1997, increasing to 5.5 percent in FY 2001 and thereafter. These projections indicate net cash inflow through FY 2004, with a crossover to net outflow in FY 2005. Cash inflows combined with interest earnings exceed cash outflows for each of the 10 years presented, although this net excess decreases from \$8.7 billion at the end of FY 1997 to \$3.9 billion at the end of FY 2006.



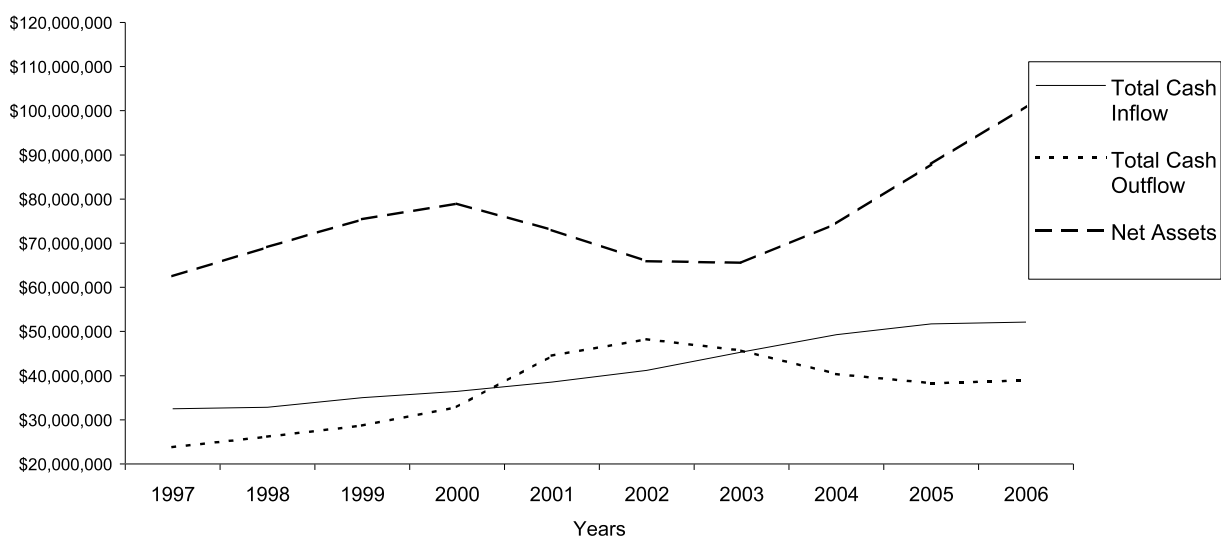
153. *Effect of Expected Cashflows on UTF Assets* - Chart II demonstrates the effect of the expected cash inflow and outflow on the net assets of the UTF over the 10-year period ending September 30, 2006. Yearly projected total cash inflows, including interest earnings, and cash outflows are depicted, as well as the net effect of this cashflow on UTF assets.

Under this scenario, total cash inflow exceeds cash outflow in each of the 10 years projected, although the margin of excess decreases by 55 percent from FY 1997 to FY 2006. Net UTF assets increase by 87 percent over the 10-year period, from \$62.5 billion in FY 1997 to \$117.0 billion in FY 2006.



154. *Recession Scenarios*—Charts III and IV demonstrate the effect on accumulated UTF assets of projected total cash inflow and cash outflow of the UTF over the 10-year period ending September 30, 2006, under moderate and severe recession scenarios. Each scenario uses an open group, which includes current and future participants in the UI program. Charts III and IV assume increased rates of unemployment during mild and deep periods of recession.

Chart III
Unemployment Trust Fund
Effect of Net Cash Flow on Net Assets

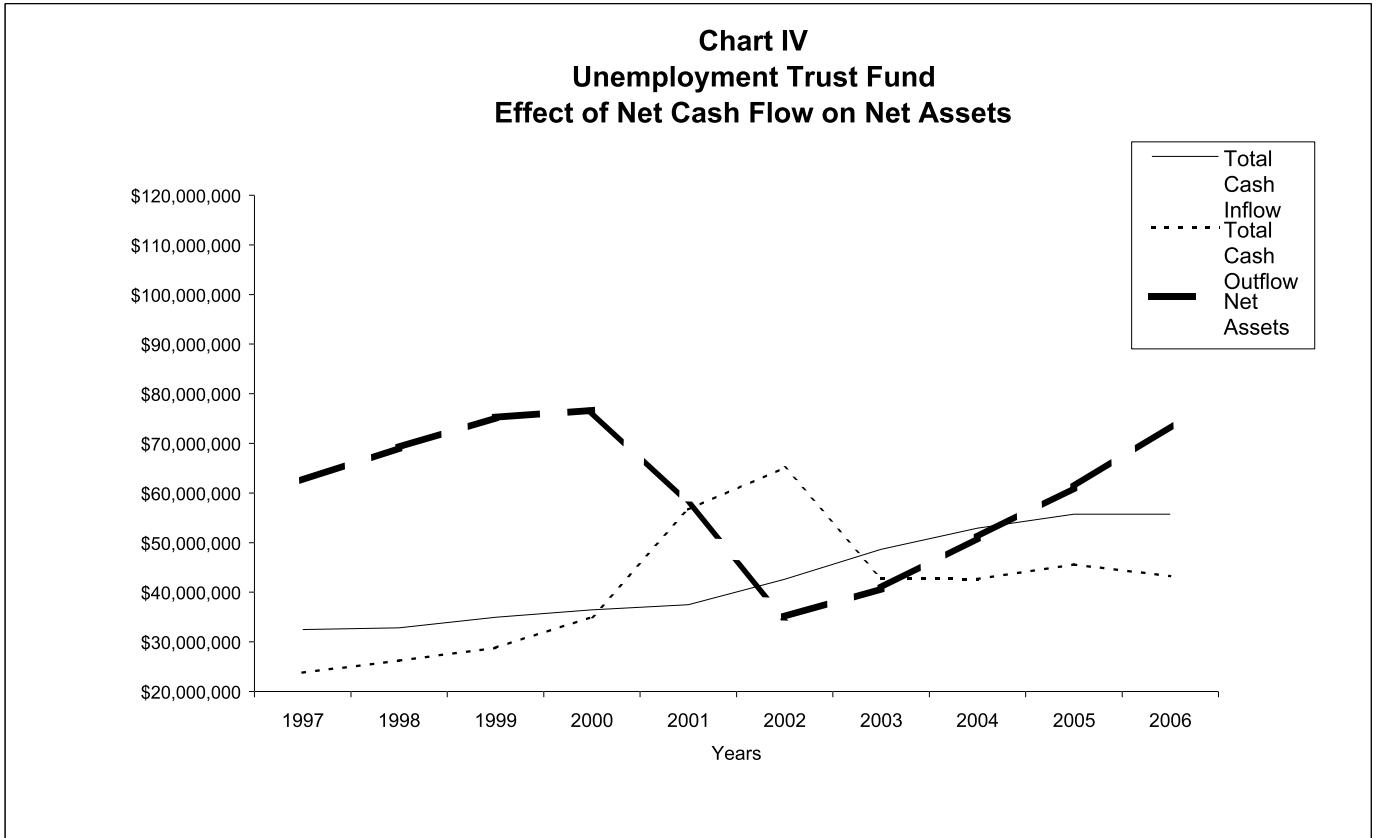


155. *Effect on UTF Assets of Mild Recession* - Chart III shows the projected effects of moderate recession on the cash inflow and outflow of the UTF. Under this scenario, which utilizes a rising unemployment rate peaking at 7.4 percent in FY 2002, net cash outflows are projected to begin in FY 2001, increasing to a maximum of \$7.0 billion in FY 2002. Net cash inflow is reestablished in FY 2004 with a drop in the unemployment rate to 6.4 percent.

156. *Effect on UTF Assets of Deep Recession* - Chart IV shows the effect of severe recession on the cash inflow and outflow of the UTF. This scenario assumes a rising unemployment rate peaking at 10.2 percent in FY 2002. Under this scenario, net cash outflows are projected to begin early in FY 2000, increasing to \$22.5 billion in FY 2002. During this two-year period, the net assets of the UTF decrease from \$76.7 billion to \$35.0 billion, a decline of \$41.7 billion (54 percent). While aggregate UTF balances remain positive, state accounts without

sufficient reserve balances to absorb negative cashflows would be forced to borrow funds from the FUA to meet benefit payment requirements. State borrowing demands could also deplete the FUA, which borrows from the ESAA and the EUCA until they were depleted. The FUA would then require advances from the general fund of the U.S. Treasury to provide for state borrowing. (See discussion of state solvency measures *infra*.)

157. Net cash inflows are reestablished early in FY 2003, with a drop in the unemployment rate to 7.82 percent. By the end of FY 2006, this positive cashflow has replenished UTF account balances to \$73.6 billion, or to within \$3.0 billion of their FY 2000 peak. This example demonstrates the counter-cyclical nature of the UI program, which experiences net cash outflows during periods of recession, to be replenished through net cash inflows during periods of recovery.



158. Tables containing the yearly cash inflow, interest earnings, and cash outflow for each scenario are presented in the following pages.

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996

(1) Expected Unemployment Rate

(Dollars in thousands)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	\$ 53,800,832	\$ 62,495,644	\$ 69,134,779	\$ 75,410,218	\$ 82,183,369	\$ 89,188,172	\$ 96,242,575	\$ 102,591,615	\$ 108,232,958	\$ 113,075,913
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,011,000	27,927,000	28,666,000	29,217,000	29,792,000	30,439,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,300,000	6,332,000	6,428,000	6,474,000	6,545,000	6,616,000	6,690,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,273,600	33,444,000	34,425,000	35,215,100	35,864,400	36,517,800	37,220,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,670,414	4,924,397	5,227,889	5,326,384	5,503,356	5,656,406	5,711,029
Total cash inflow	32,498,928	32,830,610	34,937,192	36,944,014	38,368,397	39,652,889	40,541,484	41,367,756	42,174,206	42,931,429
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,875,000	26,443,000	27,619,400	28,831,233	30,329,870	31,765,260	33,267,761	34,821,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,456,087	3,474,974	3,498,455	3,591,026	3,687,876	3,787,445	3,889,713
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,136	3,035	3,011	2,984	3,017	3,033	3,016
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,661,753	30,170,863	31,363,594	32,598,486	34,192,444	35,726,413	37,331,251	38,989,661
Excess of total cash inflow										
ex. int. over total cash outflow	4,950,484	2,459,325	1,861,847	2,102,737	2,080,406	1,826,514	1,022,656	137,987	(813,451)	(1,769,261)
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,275,439	6,773,151	7,004,803	7,054,403	6,349,040	5,641,343	4,842,955	3,941,768
Balance, end of the year	\$ 62,495,644	\$ 69,134,779	\$ 75,410,218	\$ 82,183,369	\$ 89,188,172	\$ 96,242,575	\$ 102,591,615	\$ 108,232,958	\$ 113,075,913	\$ 117,017,681
Total unemployment rate	5.09%	5.12%	5.38%	5.47%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996

(2) Mild Recessionary Unemployment Rate

(Dollars in thousands)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	\$ 53,800,832	\$ 62,495,644	\$ 69,134,779	\$ 75,427,203	\$ 78,997,497	\$ 72,977,460	\$ 65,947,568	\$ 65,595,389	\$ 74,470,094	\$ 87,923,108
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,889,000	31,018,000	35,304,000	39,150,000	41,096,000	40,839,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	34,129,000	37,265,000	41,603,100	45,587,400	47,667,800	47,479,400
Interest on Federal securities	3,744,328	4,179,810	4,485,592	4,324,625	4,389,403	3,957,469	3,737,486	3,670,448	4,053,078	4,639,297
Total cash inflow	32,498,928	32,830,610	35,009,192	36,467,225	38,518,403	41,222,469	45,340,586	49,257,848	51,720,878	52,118,697
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,930,015	29,083,333	40,393,938	44,027,625	41,544,306	36,305,687	34,175,845	34,832,298
State administrative costs	3,357,406	3,561,582	3,513,672	3,541,887	3,875,374	3,956,055	3,877,026	3,804,276	3,816,045	3,861,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,716,768	32,896,931	44,538,440	48,252,361	45,692,765	40,383,143	38,267,864	38,971,582
Excess of total cash inflow										
ex. interest over total cash outflow	4,950,484	2,459,325	1,806,832	(754,331)	(10,409,440)	(10,987,361)	(4,089,665)	5,204,257	9,399,936	8,507,818
Excess of total cash nflow										
over total cash outflow	8,694,812	6,639,135	6,292,424	3,570,294	(6,020,037)	(7,029,892)	(352,179)	8,874,705	13,453,014	13,147,115
Balance, end of the year	\$ 62,495,644	\$ 69,134,779	\$ 75,427,203	\$ 78,997,497	\$ 72,977,460	\$ 65,947,568	\$ 65,595,389	\$ 74,470,094	\$ 87,923,108	\$ 101,070,223
Total unemployment rate	5.09%	5.12%	5.38%	5.60%	6.57%	7.43%	7.07%	6.42%	5.62%	5.50%

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996

(3) Deep Recessionary Unemployment Rate

(Dollars in thousands)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	\$ 53,800,832	\$ 62,495,644	\$ 69,134,779	\$ 75,247,218	\$ 76,661,227	\$ 57,496,183	\$ 34,990,203	\$ 40,790,676	\$ 51,029,964	\$ 61,156,933
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,001,000	33,246,000	40,275,000	44,151,000	46,310,000	45,904,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	33,241,000	39,493,000	46,574,100	50,588,400	52,881,800	52,544,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,313,207	4,254,058	3,108,756	2,055,502	2,331,404	2,840,149	3,202,881
Total cash inflow	32,498,928	32,830,610	34,937,192	36,455,807	37,495,058	42,601,756	48,629,602	52,919,804	55,721,949	55,747,281
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	25,038,000	31,171,000	52,201,000	60,454,000	38,737,870	38,517,260	41,302,761	38,980,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,599,087	4,189,974	4,385,055	3,819,826	3,890,076	4,016,245	4,004,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,824,753	35,041,798	56,660,102	65,107,736	42,829,129	42,680,516	45,594,980	43,262,997
Excess of total cash inflow ex. interest over total cash outflow	4,950,484	2,459,325	1,698,847	(2,899,198)	(23,419,102)	(25,614,736)	3,744,971	7,907,884	7,286,820	9,281,403
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,112,439	1,414,009	(19,165,044)	(22,505,980)	5,800,473	10,239,288	10,126,969	12,484,284
Balance, end of the year	\$ 62,495,644	\$ 69,134,779	\$ 75,247,218	\$ 76,661,227	\$ 57,496,183	\$ 34,990,203	\$ 40,790,676	\$ 51,029,964	\$ 61,156,933	\$ 73,641,217
Total unemployment rate	5.09%	5.12%	5.38%	6.65%	9.07%	10.15%	7.82%	7.28%	7.05%	6.43%

159. ***States Minimally Solvent*** - Another measure of the sufficiency of accumulated UTF assets to meet future benefit payment requirements analyzes the adequacy of each state's accumulated net assets or reserve balance to provide a defined level of benefits over a defined period of time. To be considered minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs based on the highest levels of benefit payments experienced by the state over the last 20 years. A ratio of 1.0 or greater indicates a state is minimally solvent. States below this level are the most vulnerable to exhausting their funding in a recession. States exhausting their reserve balance must borrow funds from the FUA to make benefit payments. During periods of high sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury general fund.
160. Chart V presents the state-by-state results of this analysis at September 30, 1996, in descending order, by ratio. As the table illustrates, 23 states failed to meet the minimum solvency test of 1.0 at September 30, 1996.

Chart V

Minimally Solvent		Not Minimally Solvent	
State	Ratio	State	Ratio
Virgin Islands	2.89	Maryland	0.99
New Mexico	2.43	Alaska	0.94
New Hampshire	2.18	Nevada	0.94
Vermont	2.17	Alabama	0.90
Georgia	1.96	Kentucky	0.71
Mississippi	1.93	Arkansas	0.64
Oklahoma	1.86	Ohio	0.63
Utah	1.84	Pennsylvania	0.62
Delaware	1.74	Massachusetts	0.58
Wyoming	1.65	Michigan	0.57
Kansas	1.63	Minnesota	0.56
Puerto Rico	1.6	Maine	0.54
Virginia	1.58	North Dakota	0.54
Indiana	1.57	California	0.53
Florida	1.55	Illinois	0.50

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Minimally Solvent		Not Minimally Solvent	
State	Ratio	State	Ratio
Iowa	1.39	Rhode Island	0.47
Nebraska	1.37	Missouri	0.45
North Carolina	1.32	Dist. of Col.	0.45
Arizona	1.28	West Virginia	0.42
Idaho	1.26	Texas	0.33
South Carolina	1.24	Connecticut	0.31
Louisiana	1.23	New York	0.13
Oregon	1.2		
Wisconsin	1.18		
Montana	1.13		
Colorado	1.08		
Tennessee	1.08		
Washington	1.07		
Hawaii	1.06		
South Dakota	1.06		

Governmentwide Entity Perspective

(Note: This pro forma illustration is a partial display featuring Social Security and Medicare and is not intended to be the full consolidated presentation wherein all social insurance programs would be summarized and consolidated in accordance with par. 32.)

Stewardship Information: Consolidated Statement of Social Insurance - 75-Year Projection^a as of September 30, 1996 [HYPOTHETICAL DATA]

Dollars in Trillions

	1996	Prior Years			
		1995	1994	1993	1992
<i>Actuarial present value of future benefit payments^b during the 75-year period to or on behalf of:</i>					
Current participants not yet having attained retirement age ^c	\$ X	\$ X	\$ X	\$ X	\$ X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Current participants who have attained retirement age ^c	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Subtotal—benefit payments for the 75-year period	X	X	X	X	X
<i>Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:</i>					
Current participants who have not yet attained retirement age ^c	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]

(Continued From Previous Page)

Dollars in Trillions

	Prior Years				
	1996	1995	1994	1993	1992
Current participants who have attained retirement age ^c	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]
Subtotal—benefit payments for the 75-year period	Y	Y	Y	Y	Y
<i>Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period^d</i>	\$ X	\$ X	\$ X	\$ X	\$ X

Notes to the Statement:

^aThe projection period for new entrants covers the next 75 years. The projection period for current participants (or "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years in a few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

^b"Benefit payments" include administrative expenses.

^cThe actuarial net present value of the excess of future benefit payments to current participants (that is, to the "closed group" of participants) over future contributions and tax income from them or paid on their behalf is calculated by subtracting the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

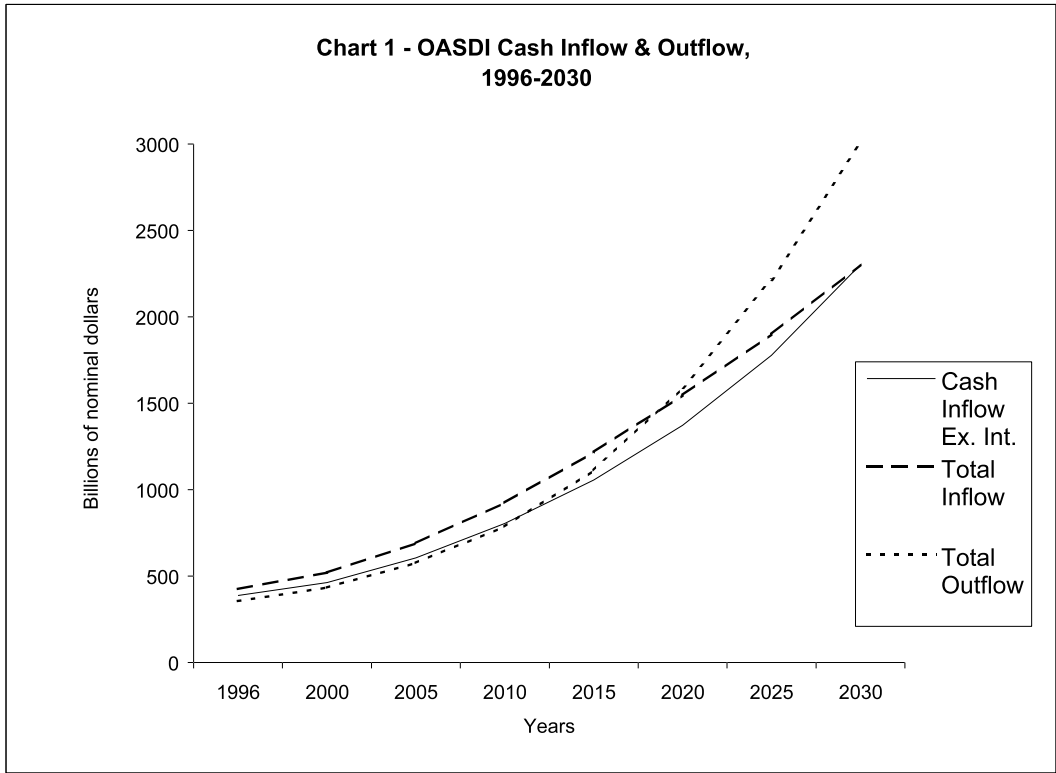
^dThe fund balance—which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over all past cash outflow within the program—for fiscal year 1996 is \$ X, trillion. The fund balances for 1995-2, in trillions, were \$X₂, X₃, X₄, X₅, respectively. The accumulated excess of cash inflow over outflow at the valuation date consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

Program Description

161. As discussed in Note X to the *CFS*, a liability of \$75 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of Old-Age, Survivors, Disability Insurance (OASDI), Medicare (HI and SMI), and other social insurance benefits due to recipients or service providers for periods ended on or before September 30, 1996. Most of this amount was paid in October 1996.
162. While no liability has been recognized on the balance sheet for future payments beyond the amount due as of September 30, actuarial estimates of future program activities have been prepared for the social insurance programs. Long-term actuarial views are a critical

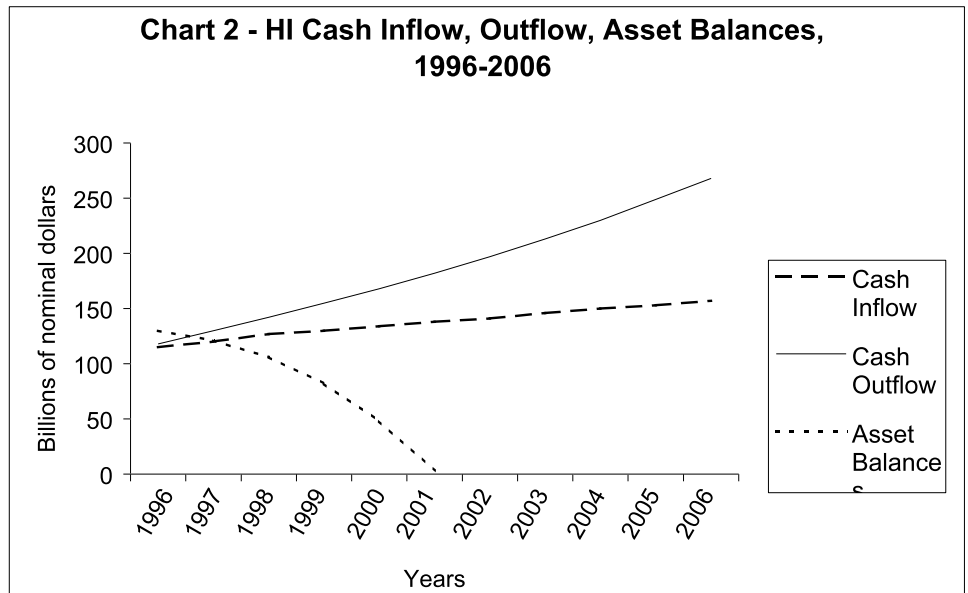
element in assessing the financial condition of social insurance programs. In addition, social insurance programs must be assessed as a large and growing part of the governmentwide financial entity where they impact the balance between future government obligations and resources.

163. By projecting receipts from all sources and outlays for all federal programs for all purposes—as is the goal when analyzing trends in the federal budget, and as shown for the short-term in the Current Services Estimate, which shows the current and six future years (see page XX of this report)—it is possible to examine whether there will be sufficient resources to support all the government’s ongoing responsibilities. It is also possible to see the interrelationship among the various types of government receipts (e.g., income taxes, payroll taxes, exchange revenue) and outlays (e.g., social insurance, national defense), where increases/decreases in one area of the budget can be offset by decreases/increases in other areas. Another perspective for assessing the financial condition of the government is its relationship to the national economy as measured by the GDP.
164. The actuarial present values and projections presented here for Social Security and Medicare, which are by far the largest social insurance programs, use the best estimate of the programs’ actuaries of future costs over periods ranging up to 75 years. Estimates extending so far into the future, however, are inherently uncertain; and the uncertainty is greater for the later years in the period.
165. As shown in Chart 1, under current policies Social Security cash outflow will exceed inflow from the public in about 2012.



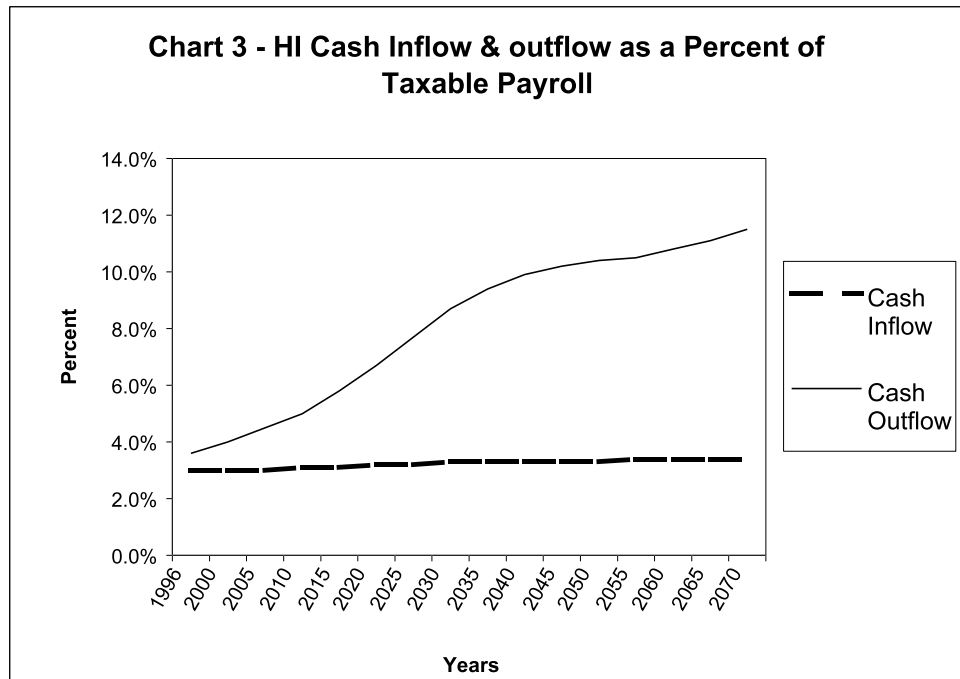
Source: Data from Tables III B1, B3, C1, 1996 OASDI Trustee's Report.

166. The Medicare Hospital Insurance (HI) program cash outflow exceeded annual cash inflow in FY 1996. using the actuaries' best estimate, the HI program will be insolvent in 2001, as shown in Chart 2 below. Projected HI payroll tax will meet a declining share of cash outflow under present law. Tax receipts are expected to equal 84 percent of cash outflow in 1997 and 74 percent in 2001 and would cover less than one-third of costs 75 years from now.



Source: Data from Table II D3, 1997 HI Trustee's Report.

167. The Medicare Supplementary Medical Insurance (SMI) is funded by premiums paid by participants and annual general fund appropriations. Current law provides for annual calculations of expected cost. Premiums, which currently cover approximately 25 percent of the program's cost, are expected to pay 16 percent by 2006 and decline further thereafter.
168. SMI benefits have been growing rapidly. Expenditures have increased 45 percent over the past five years. During this period the program grew about 14 percent faster than the economy as a whole, despite efforts to control costs.
169. As presently constructed, the HI program receives most of its income from the 1.45 percent payroll tax that employees and employers each pay, for a total of 2.9 percent of taxable payroll. Chart 3 below illustrates the cost rate of this program relative to its income rate as a percentage of taxable payroll.



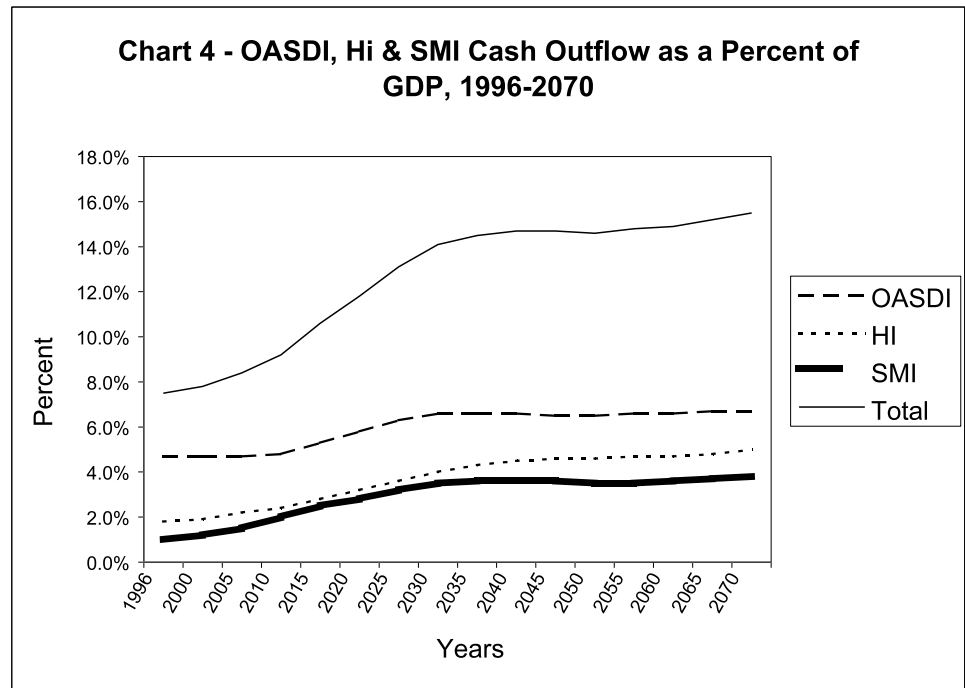
Source: Data from Table II A.2, 1997 OASDI Trustee's Report.

170. Medicare is currently paying and, from 2012 forward, OASDI would pay more to the public than they receive in taxes thereby increasing the government's financing needs. Compared to a situation in which taxes or other financing sources equalled cash outflow, the government will have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.
171. ***Growing Disparity Between Rates of Income and Outgo*** - The excess of OASDI and HI cash outflow over inflow and the decreasing percent of SMI cost covered by premiums is due to the increasing cost of existing medical care; the increased utilization of existing and new health care techniques; and, in later years, the retirement of the "baby boom" generation and the relatively small number of people born during the subsequent period of low birth rate. For example, the OASDI Trustees' best estimate shows a long-term actuarial deficit over the next 75 years of 2.17 percent of taxable payroll—in other words, a tax increase today of 1.09 percent of taxable payroll each for employees and employers, over the 6.2 percent they each now pay

would produce enough revenue to pay benefits under current law, over 75 years.²⁶ Increasing the payroll tax from 12.4 to 14.6 represents a payroll tax increase of about 17 percent. The 2.17 percent deficit represents, in terms of present value, an excess of \$3.1 trillion of expenditures over contribution.

172. ***Social Insurance in Relation to the National Economy*** - The security of benefits and the distribution of financing costs for social insurance programs cannot be determined solely on the basis of the financial and actuarial status of the programs by themselves. Sustainability from the governmentwide entity perspective is better measured in terms of a healthy relationship between social insurance programs—and, indeed, the entire budget—and the national economy, as measured by the GDP. Relative to the national economy, federal spending for OASDI, HI, and SMI was 7 percent of GDP in 1996—\$550 billion. By 2030, when most baby boomers will have retired, these programs are projected to consume nearly 100 percent more of GDP than they do today—14 percent, as shown in Chart 4.

²⁶[Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 3.]



Source: Data from Table III C1, 1996 OASDI Trustee's Report and Table III B1, 1997 HI Trustee's Report.

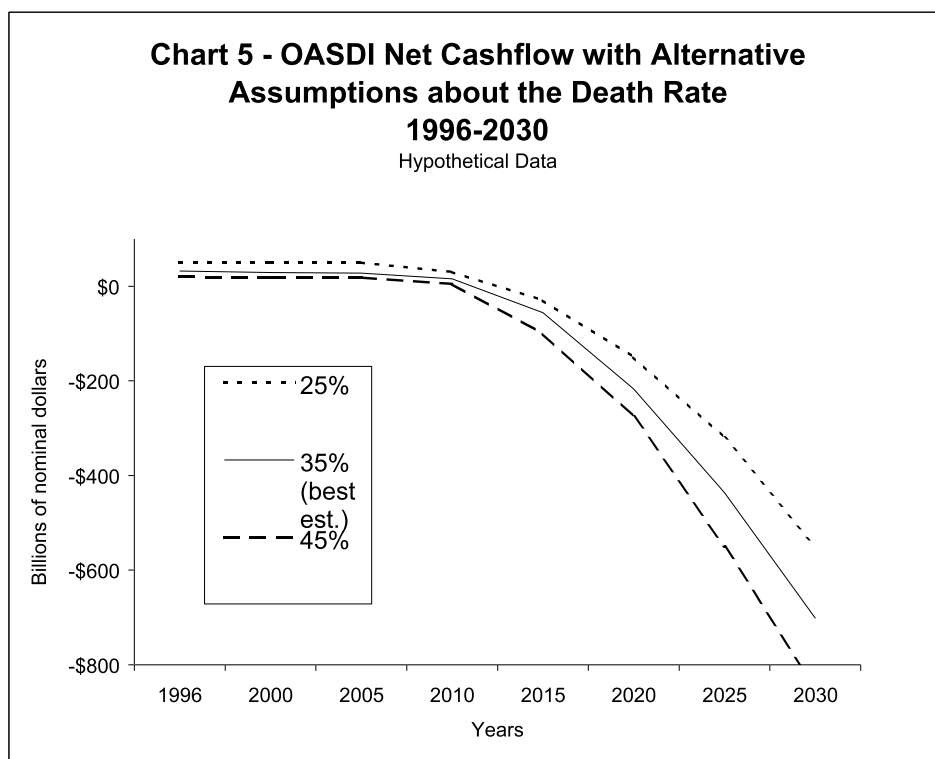
173. This projected increase needs to be understood in the context of other projected future claims on future resources including general assistance programs (e.g., Medicaid) and other federal programs. Nearly all of the increase between now and 2030 in the OASDI, HI, and SMI programs will occur between 2010 and 2030, as retired baby boomers become eligible for those programs. In terms of the number of workers to beneficiaries in the combined OASDI and HI programs, a decline will occur from about 3.5 per beneficiary in 1995 to 2 per beneficiary in 2030.

174. ***Sensitivity Analysis***²⁷ - The future cashflow of the OASDI, Medicare, and other social insurance programs depends on many

²⁷[Please note: this section provides examples of some of the sensitivity analysis that would be provided at the consolidated level. The consolidated entity would summarize the sensitivity analyses from the individual social insurance entities.]

economic and demographic assumptions. Precise long-range projections of these factors is impossible.

175. This section illustrates the sensitivity of the long-range projections to changes by analyzing six key individual assumptions. For this analysis the “best estimate” cost assumptions are used as the reference point, and each assumption is varied within it individually.
176. *Death Rate* - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during 1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.



Source: Data for “best estimate” is from Tables III B1, B3, C1, 1996 OASDI Trustee’s Report.

177. *Real Interest Rate*—The total excess of OASDI cash outflow over inflow on the basis of the best estimate cost assumptions is

\$3.0 trillion over the valuation period of 1996-2070. If the annual real interest rate for Treasury securities is changed from the 2.3 percent used for the best estimate to 1.5 percent, the excess of cash outflow would increase to \$3.8 trillion; if the rate were changed to 3 percent, the excess of cash outflow would decrease to \$2.5 trillion.

178. *Birth Rate* - Table 1 shows the effect of using birth rates of 1.6 and 2.2 children per woman, instead of the 1.9 rate used for the best estimate projection, on the total excess OASDI cash outflow over inflow over the period 1996-2070. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions - Valuation Period: 1996-2070

Valuation Period: 1996-2070	Ultimate Birth Rate Per Woman		
	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	\$3.7	\$3.0	\$2.5

179. *Net Immigration*—Table 2 below shows the total excess of OASDI cash outflow over inflow with various assumptions about the magnitude of net immigration.

Table 2- Estimated OASDI Actuarial Balances with Various Net Immigration Assumptions

Valuation Period: 1996-2070	Net immigration per year		
	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over inflow	\$3.2	\$3.0	\$2.9

180. *Real-Wage Differential* - Table 3 below shows the total excess OASDI cash outflow over inflow with various assumptions about the real-wage differential. The real-wage differential is the difference between

the annual percentage increase in wages in covered employment and the Consumer Price Index.

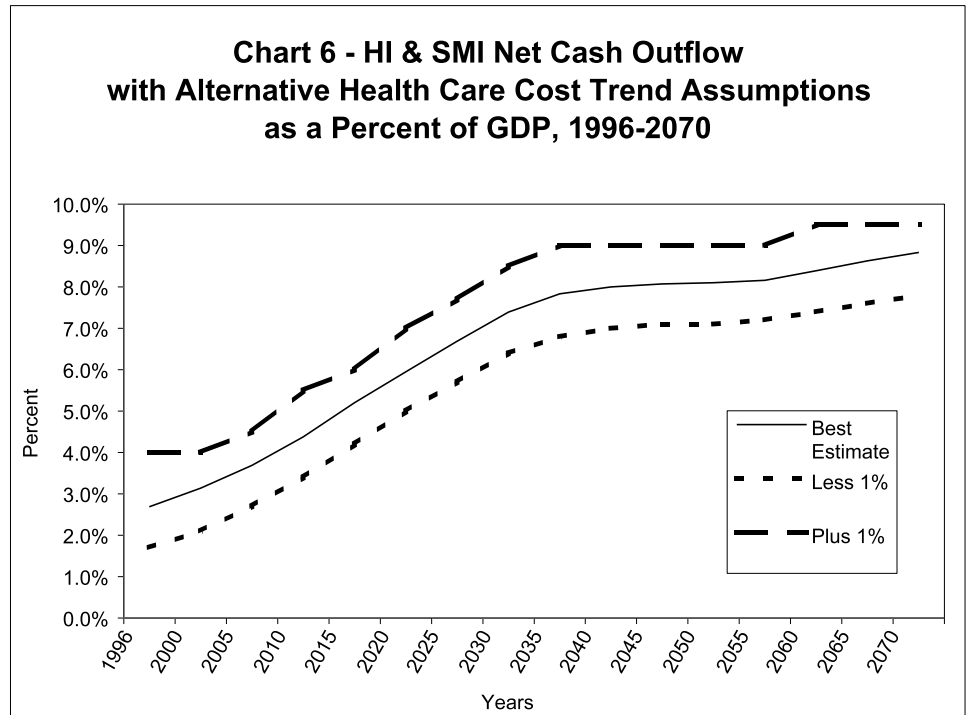
Table 3- Estimated OASDI Actuarial Balances with Various Real-Wage Assumptions - Valuation Period: 1996-2070

Dollars in trillions

	Ultimate percentage in wages-CPI ^a		
	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Wages-CPI			
Excess cash outflow over inflow	\$3.9	\$3.0	\$2.3

^a [The first value in each of the pairs below is the assumed ultimate annual percentage increase in average wages in covered employment. The second value is the assumed ultimate annual percentage increase in the CPI. The difference between the two values is the real-wage differential.]

181. *Health Care Cost Trend*—Chart 6 below shows the estimated HI and SMI net cash outflow using a health care cost factor 1 percent above and 1 percent below that used for the “best estimate” projection. Factors such as wage increases and price increases may simultaneously affect both HI payroll tax income and the costs incurred by hospitals and other providers of medical care to HI and SMI beneficiaries. Other factors, such as the utilization of services by beneficiaries or the relative complexity of the services provided, can affect provider costs without affecting HI payroll tax income. The sensitivity analysis shown in Chart 6 illustrates the financial effect of any combination of such factors that results in aggregate provider costs increasing by 1 percent faster or slower than the “best estimate” assumptions.



Source: Data for "best estimate" is from Table III B1, 1997 HI Trustee's Report.

Appendix C - Historical Background

182. **Practice Prior to Federal Accounting Standards Advisory Board (FASAB)** - Although this statement is applicable to other social insurance programs, Social Security historically has been the primary focus when considering accounting for social insurance. Over the decades, the debates about Social Security have to some extent paralleled debates in the nonfederal accounting community about how to apply accrual concepts in accounting. During this time, a continual evolution in accounting practice has led to increased recognition on the face of the financial statements and disclosure in notes to financial statements of formerly unreported commitments such as pensions and other postretirement benefits such as health care.
183. Since the 1950s, the Treasury Department and the Office of Management and Budget (OMB) have been furnishing reports on federal contingencies and commitments. From the early 1950s, the reports showed, among other commitments, the face value of loan guarantees and federal insurance but not the actuarial status of social insurance programs.
184. In 1967, Congress began requiring a commitments and contingencies report (*Liabilities and Other Financial Commitments of the United States Government*) that was to include liabilities of federal annuity programs and their actuarial status. The programs in that report included most of the social insurance programs that are the subject of these accounting standards: Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance. The report was tied with the regular business-type reporting of federal agencies required by the Treasury Department (e.g., balance sheets, operating statement, supplemental schedules).
185. From 1976 until 1985, the “prototype” *Consolidated Financial Statements of the United States Government (CFS)* recognized a liability for Social Security using a calculation similar to that called for in APB 8 (1966), which defined a variety of acceptable actuarial methods for measuring pension expense and required that any accumulated, unfunded pension expense be recognized as a liability. However, the expense shown on the *CFS* operating statement included only cash benefit payments and not what the *CFS* called the “noncash amount”—or the change in the unfunded liability.

186. After 1966 the importance of information about pensions grew due to increases in the number of plans and amounts of pension assets and obligations. Significant changes occurred in both the legal environment (e.g., Employee Retirement Income Security Act) and the economic environment (e.g., higher inflation and interest rates).
187. APB 8 was superseded by FASB Statement of Financial Accounting Standards (SFAS) No. 87, *Employer's Accounting for Pensions*, published in December 1985. FASB noted the years of accounting controversy over measuring costs and liabilities resulting from defined benefit pension plans. After considering the range of comments on its *Preliminary Views* document and on its exposure draft, FASB concluded that, although it did not recognize the full projected benefit obligation on the balance sheet, SFAS 87 represented a worthwhile improvement in financial reporting. SFAS 87 made accounting for pensions more independent of the financing arrangements, provided more standardization in measurement of the pension expense and liability, and required at least a "minimum liability" to be recognized in employers' balance sheets.
188. The Social Security liability was de-recognized in the *CFS* for 1985; but a similar closed group (to new entrants),²⁸ "liability type" number continued to be disclosed in a footnote along with the open group, "cashflow" or "financing type" number. The closed group population includes all current participants, that is, retirees and covered workers. The "open group" includes all current participants plus all future participants over the next 75 years. Disclosure of the closed group number was discontinued in the *CFS* after 1994.

FASAB Exposure Drafts
on Liabilities &
Stewardship

189. Social insurance was addressed in the Board's exposure draft (ED) on *Accounting for the Liabilities of the Federal Government* in November 1994. The *Liabilities* ED proposed defining a federal liability in terms generally similar to the definition used by privately owned entities in the United States: a probable and measurable future sacrifice of resources based on a past transaction or event. However, to accommodate the unique circumstances of the Federal Government, both the *Liabilities* ED and the subsequent Statement of Federal Financial Accounting Standards No. 5 distinguished between

²⁸"Closed group" will be used synonymously with "closed group (to new entrants)."

exchange and **non**exchange transactions and provided distinct accounting for liabilities resulting from these two types of transactions.

190. Private sector accounting concepts and standards distinguish between reciprocal transactions (such as payments to an employee for services rendered) and non reciprocal transactions (such as contributions pledged to a not-for-profit entity). This is generally analogous to the federal distinction between exchange and nonexchange transactions. Private sector accounting standards, however, do not recognize liabilities differently based upon whether they arise from reciprocal or non reciprocal transactions.
191. For nonexchange transactions, the *Liabilities* ED provided that a liability would be recognized for any unpaid amounts due and payable as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, whether or not such amounts have been reported to the federal entity (e.g., estimated Medicare payments due to health providers for service that has been rendered and that will be financed by the federal entity but that have not yet been reported to the federal entity).
192. After much debate, social insurance benefits were classified as nonexchange transactions. The *Liabilities* ED proposed that such programs recognize the following as expense in the statement of net cost: (1) the benefits and expenses paid during the year (except those accrued at the end of the prior year) and (2) the benefits and expenses due and payable at the end of the year. The latter were to be recognized as liabilities on the balance sheet. The *Liabilities* ED noted that the FASAB contemplated a federal reporting model encompassing extensive disclosure and supplementary reporting and that the Board was addressing such reporting for social insurance in a separate project. Also, the *Liabilities* ED contained an alternative view whereby a minimum liability—representing the actuarial present value of total lifetime benefits due to be paid to people eligible to receive social insurance benefits at the balance sheet date—would be recognized on the balance sheet.
193. The Board considered the responses to the *Liabilities* ED in conjunction with its continuing development of supplementary information for social insurance programs. The majority of

respondents favored the alternative view, that is, recognition of a minimum liability. Because the *Liabilities* ED had focused on balance sheet presentation and did not contain any proposed supplementary disclosures and because the magnitude and complexity of the issues were so great, the Board chose to issue a standard on liabilities without any additional requirements for social insurance and to expose the supplementary information for comment. In August 1995, the Board released for comment proposed required supplementary information for social insurance programs in the exposure draft on *Supplementary Stewardship Reporting* (“*Stewardship* ED”).

194. The *Stewardship* ED did not change the recognition point for expenses and liabilities published in the *Liabilities* ED. However, it proposed the following three liability-type measures to be reported as required supplementary information accompanying the financial statements: (1) a “minimum liability” (present value of benefits due to all currently eligible to receive them) and (2) the actuarial net present value of benefits and payments to (a) the closed group (that is, current program participants) and (b) the “open group” (current and future program participants) for the next 75 years. In addition, it proposed a “money’s worth” measure (data showing the change over time in the ratio of the net present value of actual or estimated average aggregate lifetime benefits paid to and contribution received from and on behalf of similarly aged participants).
195. The response to the *Stewardship* ED’s required supplementary stewardship information package regarding social insurance was generally favorable. The majority of respondents said that the information was either very useful or useful. Others, including representatives of the administrative agencies for Social Security and Medicare, objected to reporting any information other than that based on the open group methods and assumptions. Also, opposition arose from the agency administering unemployment insurance and Black Lung benefits, stating that although its programs should be included as social insurance, the RSSI package designed for Social Security did not fit its programs because they involved short-term benefits or had other unique aspects.
196. After deliberating the issues, the Board concluded in May 1996 that additional investigation and further deliberation were required. The Board noted:

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- the strength of feelings on the issues (with one side firmly believing that the closed group estimate is a liability that should be recognized on the consolidated balance sheet of the Federal Government and, at the opposite pole, others who firmly believe that the closed group estimate is meaningless, could be misleading, and should not be disclosed at all in federal financial reports);
 - the magnitude and complexity of the issues; and
 - that changes to social insurance programs were being studied and discussed frequently and seriously within government and by the public.

197. The Board directed the staff to continue researching social insurance accounting, focusing especially on identifying the following:

- the characteristics of such programs, the appropriate display of information in the financial statements, and any additional information that should be required;
- the means for measuring financial data in such information; and
- the desirability of other indicators (ratios of data to Gross Domestic Product (GDP) or “covered payroll”) to describe the status of programs.

The Board instructed the staff to be mindful of developments in the policy studies of Social Security in structuring its research and its recommendations.²⁹ In early 1997, the Board began again to deliberate the issues. The standard is a product of this project.

²⁹SFFAS No. 8, *Supplementary Stewardship Reporting*, par. 117. The studies included the 1994-96 Social Security Advisory Council whose report, published in January 1997, reflected the lack of consensus on long-term financing for Social Security. The Council members agreed on how to define the size of the financing problem (by using the Social Security Administration actuaries’ “best estimate” projection to derive an actuarial deficit of 2.17 percent of payroll over the next 75 years). They also agreed that two long-range goals should be (1) to eliminate the 2.17 percent 75-year deficit and (2) to have the fund in stable condition at the end of the 75-year period. However, the Council offered three sharply different models for the future of Social Security. These models did contain some common features (e.g., all three would increase from 35 to 38 the number of years used to compute benefits and tax Social Security benefits in the same way that contributory defined-benefit pensions are treated under the federal income tax). In addition to the Advisory Council, academics and scholars were studying, for example, the Chilean and United Kingdom experiments with privatization of public pension plans.

**Appendix D -
Glossary**

See also Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Statement of Federal Financial Accounting Standards 18: Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2

Status

Issued	May 2000
Effective Date	For fiscal periods beginning after September 30, 2000.
Volume II References	Loans and Loan Guarantees (L60)
Interpretations and Technical Releases	TR 3 (Revised), Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i> TR 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>
Affects	SFFAS 2
Affected by	SFFAS 19

Summary

This Statement presents amendments to certain portions of Statement of Federal Financial Accounting Standards 2, *Accounting for Direct Loans and Loan Guarantees*, (SFFAS 2), which was issued in August 1993. The objectives of these amendments are to improve financial reporting for subsidy costs and performance of Federal credit programs.

During 1998 and early 1999, the Board discussed issues related to reporting the credit subsidy expense and credit subsidy reestimates in general. The Board concluded that certain portions of SFFAS 2 should be amended so that more useful information on credit programs' subsidy costs and performance will be provided to citizens, Congress, program managers, and other users of Federal financial information. The amendments were proposed for public comment in an Exposure Draft published in March 1999. After considering comments, the Board decided to adopt the following amendments:

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

The former is a reestimate due to a change in interest rates from the rate assumed in budget preparation and used in calculating the subsidy expense to the rates that are prevailing at the time the direct or guaranteed loans are disbursed. The latter is a reestimate due to changes made in projected cash flows under the terms of the direct loans or loan guarantees after reevaluating all the risk factors as of the financial statement date, except for the effect of interest rate reestimates.

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

The reconciliation displays activities that affect the subsidy cost allowance or the loan guarantee liability, such as the subsidy expense for direct or guaranteed loans disbursed during the reporting period, subsidy reestimates, fees received, interest supplements paid, loans written off, claim payments made to lenders, recoveries obtained, and other adjustments.

Provide a description of program characteristics and disclose (1) the amounts of direct or guaranteed loans disbursed in each program during the reporting year, (2) the estimated subsidy rates for the total subsidy and the subsidy components at the program level in the current year's budget for the current year's cohorts, (3) events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates; and (4) 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.

Reporting entities should discuss how those events and changes have affected or would affect credit programs' subsidy costs, subsidy reestimates, and the subsidy rates estimated in the budget.

In addition to requiring reconciliation for the balances of direct loan allowance and loan guarantee liability on an entity-wide basis as prescribed in this statement, the Board recognizes that reconciliation on a program-by-program basis can better reveal information relevant to program performance. Since the program-by-program reconciliation was not proposed for public comment in the March 1999 ED, the Board has not received input on this option. Because the proposal appears to have merit, the Board has decided to issue an exposure draft to propose program-by-program reconciliation for major programs in addition to the entity-wide reconciliation.

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Introduction

Purpose

1. The purpose of this Statement is to amend accounting standards for direct loans and loan guarantees by adding the following requirements: (a) report subsidy reestimates in two components: interest rate reestimates and technical/default reestimates, (b) display in a note to financial statements a reconciliation between the beginning and ending balances of loan guarantee liability and the subsidy cost allowance for direct loans, and (c) provide disclosure and discussion for changes in program subsidy rates, subsidy expense, and subsidy reestimates.

Background

2. During 1998 and 1999, the Board held discussions on what improvements could be made to financial reporting for credit subsidy rates, subsidy expense, and subsidy reestimates.¹ During the discussions, the Board directed its staff to conduct a survey in two issue areas: (a) How difficult is it for agencies to prepare and report subsidy data, and (b) What subsidy data are useful to users of Federal agency financial reports.
3. In June 1998, representatives of the Small Business Administration and the Department of Education made presentations to the Board on their experience and capabilities for preparing subsidy cost data for direct loans and loan guarantees. The presentations indicated that to meet the budgeting requirements, agencies must have systems and procedures to estimate for each cohort of direct loans or loan guarantees the subsidy rates, subsidy expense, and subsidy reestimates in components as currently required in preparing the budget. The presentations indicated that if a sound system is in place, the information on subsidy rates, subsidy expense, and subsidy

¹The discussions were initiated by the Credit Reform Task Force of the Accounting and Auditing Policy Committee (AAPC) which proposed that paragraph 25 in SFFAS No. 2 be amended to require disclosure of subsidy rates estimated in the budget for the current year cohorts in lieu of reporting the dollar amounts of the subsidy components. That proposal was discussed in the March 1999 ED. The Board accepted the Task Force proposal for disclosing subsidy rates, but did not remove the requirement for reporting the dollar amounts of subsidy expense components.

reestimates can be retrieved and aggregated on a program or entity basis to meet the financial reporting requirements.

4. A questionnaire on data usefulness was sent to congressional staff members who had been involved in Federal credit programs. Oral and written responses were received from a number of the staff members and were presented to the Board at its October 1998 meeting. All of those who responded indicated that for appropriation and oversight purposes, they needed more rather than less detailed data on subsidy costs for direct loans and loan guarantees. They preferred that subsidy data be reported by component in both rates and dollar amounts. Furthermore, they said that they would like to compare initial budget expectations with current reestimates and to know causes that explain changes in subsidy rates.
5. The Board agreed that the subsidy cost information reported by Federal credit agencies could be improved by adopting the following requirements: (a) report subsidy reestimates by component, (b) display in a note to financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees, and (c) provide disclosure and discussion that would help the reader understand the changes in Federal credit programs' subsidy costs and performance. These requirements were proposed in the Exposure Draft issued in March 1999 (the March 1999 ED).
6. The Board received comments from twelve respondents. Of those respondents, ten were from Federal agencies (including the CFO Council of the Federal Government), and two were from the private sector. They were generally in favor of the Board's proposals to improve financial reporting for credit programs' subsidy costs and performance. However, some of them expressed different views on some of the proposals, which are addressed in Appendix A, Basis for Conclusions. After considering the comments, the Board decided to issue in this final statement all of the amendments proposed in the March 1999 ED.
7. The Board considered and agreed with the view that reconciliations for direct loan allowance and loan guarantee liability on a program-by-program basis can better reveal variations in program characteristics and performance. Since the program-by-program reconciliation was not proposed for public comment in the March 1999 ED, the Board has

not received input on this option. Because the proposal appears to have merit, the Board will issue an exposure Draft to propose reconciliation for major programs in addition to the entity-wide reconciliation prescribed in this statement.

Effective Date

8. The accounting standards prescribed in this statement are effective for periods beginning after September 30, 2000. Earlier implementation is encouraged.

**Accounting
Standards For
Direct Loans And
Loan Guarantees**

Subsidy Reestimates-An
Amendment To SFFAS
No. 2

9. Paragraph 32 in SFFAS No. 2 is amended to read:

Credit programs should reestimate the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees as required in this standard. There are two kinds of reestimates: (a) interest rate reestimates, and (b) technical/default reestimates.² Entities should measure and disclose each program's reestimates in these two components separately. An increase or decrease in the subsidy cost allowance or loan guarantee liability resulting from the reestimates is recognized as an increase or decrease in subsidy expense for the current reporting period.

- (A) An interest rate reestimate is a reestimate due to a change in interest rates from the interest rates that were assumed in budget preparation and used in calculating the subsidy expense to the interest rates that are prevailing during the time periods in which the direct or guaranteed loans are disbursed. Credit programs may need to make an interest rate reestimate for cohorts from which direct or guaranteed loans are disbursed during the

²The term "technical/default reestimate" used in this statement is identical in meaning to the term "technical reestimate" used in OMB Circular A-11, as revised in July 1999.

reporting year. If the assumed interest rates that were used in calculating the subsidy expense for those cohorts differ from the interest rates that are prevailing at the time of loan disbursement, an interest rate reestimate for those cohorts should be made as of the date of the financial statements.

- (B) A technical/default reestimate is a reestimate due to changes in projected cash flows of outstanding direct loans and 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 reestimates explained in (a) above. In making technical/default reestimates, reporting entities should take into consideration all factors that may have affected various components of the projected cash flows, including defaults, delinquencies, recoveries, and prepayments. The technical/default reestimate should be made each year as of the date of the financial statements.

Reconciliation

10. In a note to the financial statements, reporting entities should display a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported in the entities' balance sheet. The reconciliation is accomplished by adding to or subtracting from the beginning balance the dollar amounts of the following items: (a) the subsidy expense recognized in the four components as defined in paragraphs 25 through 29 for direct or guaranteed loans disbursed during the reporting year, (b) the two types of subsidy reestimates as defined in paragraph 32, and (c) other adjustments. For direct loans, the other adjustments include loan modifications, fees received, loans written off, foreclosed property or other recoveries acquired, and subsidy allowance amortization. For loan guarantees, the other adjustments include loan guarantee modifications, fees received, interest supplements paid, claim payments made to lenders, foreclosed property or other recoveries acquired, and interest accumulated on the loan guarantee liability. The requirement to display reconciliation applies to direct loans and loan guarantees obligated or committed on or after October 1, 1991, the effective date of the Federal Credit Reform Act of 1990. Reporting entities are encouraged but not required to display reconciliations for direct loans and loan guarantees obligated or committed prior to October 1, 1991,

in schedules separate from the direct loans and loan guarantees obligated or committed after September 30, 1991.

Disclosure And Discussion

11. The disclosure and discussion requirements are prescribed in paragraphs 11(A) through 11(C):
 - (A) Reporting entities should provide a description of the characteristics of the programs that they administer, and should disclose for each program: (a) the total amount of direct or guaranteed loans disbursed for the current reporting year and the preceding reporting year, (b) the subsidy expense by components as defined in paragraphs 25 through 29, recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy reestimates by components as defined in paragraph 32 for those years.
 - (B) Reporting entities should also disclose, at the program level, the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs (net of recoveries), fees and other collections, and other costs, estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts. Each subsidy rate is the dollar amount of the total subsidy or a subsidy component as a percentage of the direct or guaranteed loans obligated in the cohort. Entities may use trend data to display significant fluctuations in subsidy rates. Such trend data, if used, should be accompanied with analysis to explain the underlying causes for the fluctuations.
 - (C) Reporting entities should disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy reestimates. The disclosure and discussion should also include events and changes 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. Changes in legislation or credit policies include, for example, changes in borrowers' eligibility, the levels of fees or interest rates charged to borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed.

Appendix A: Basis For Conclusions

Subsidy Reestimates

12. Paragraph 32 in SFFAS No. 2, as amended, requires that entities measure and disclose reestimates in two components separately; namely, the interest rate reestimate and the technical/default reestimate. The former is a reestimate made for differences between interest rate assumptions at the time of budget formulation (the same assumption is used at the time of obligation or commitment) and the actual interest rates for the years of disbursement.³ The latter is a reestimate due to changes in projected cash flows as reflected in the direct loan allowance and loan guarantee liabilities at the beginning of each fiscal year, after reevaluating the underlying assumptions and other factors that affect cash flow projections as of the financial statement date, except for any effect of interest rate reestimates.
13. As explained in the March 1999 ED, the rationale for separating the two reestimate components lies in the fact that interest rate reestimates and technical/default reestimates differ in nature. The interest rate reestimate depends on how close the assumed interest rate, which is initially used in the budget, is to the actual interest rates prevailing at the time of loan disbursement. The interest rate reestimate does not in itself indicate changes in the quality of loan assets or the overall risk of loan guarantees, nor does it have any implication for the quality of the agency's subsidy estimation process. The technical/default reestimate, on the other hand, reflects the latest developments in risk and program characteristics and thus it indicates changes in the quality of loan portfolio or the overall risk of loan guarantees. In some instances, a large technical/default reestimate may indicate that the credit program management should find ways to improve its subsidy estimation process and/or its portfolio management. Because of the difference in the nature of the two components, separate reporting would provide better information to users of the financial reports.

³See OMB Circular A-11, sec. 85.5 (a), revised in July 1999. The interest rate reestimate does not involve any change in original assumptions other than the interest rates.

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14. All of the 12 respondents to the March 1999 ED agreed with the Board's proposal for reporting subsidy reestimates in those two components. The respondents believe that reporting the two reestimate components separately will provide information to reveal the causes of the reestimates. They believe that such information can help program managers improve credit program performance and subsidy estimation methodology.
 15. Although in support for the proposal, one respondent commented on the controllability argument. Since it was discussed in the March 1999 ED that the magnitude of an interest rate reestimate is beyond agencies' control, the respondent pointed out that some default factors, such as changes in economic conditions and natural disasters, are also beyond the control of credit programs. While it was stated in the March 1999 ED that "the assumed rate is determined by the Administration and is beyond the control of the agency," that statement does not imply that credit programs can control changes in economic conditions or all of the other events that would impact default rates. However, the Board believes that a reliable assessment of the economic changes and other risk factors in making default subsidy reestimates, whether or not controllable by the agency, can help credit programs better manage program costs and performance.
 16. Another respondent stated that analyses performed by his agency indicated that in past years, changes in interest rates produced relatively minor changes in that agency's overall subsidy rates. Thus, the respondent suggested that the Board consider whether it is cost-beneficial to separate out the interest rate reestimates.
 17. The interest rate reestimates vary in magnitude from year to year. For some years, the assumed and the actual rates may be fairly close, whereas in other years they differ significantly and could produce a material effect on the overall subsidy rate. For example, the subsidy reestimate data provided USDA Rural Development Water and Waste Direct Loan program indicated that for fiscal years 1992 through 1994, the amounts of interest rate reestimates exceeded the amounts of technical/default reestimates. In 1995, the interest rate reestimate accounted for 84 percent of the total subsidy reestimate. In more recent years, the impact of interest rate reestimates was relatively small. In any case, we do not believe one can rely on the past experience for any particular year to make a conclusion about interest variations in future years.

Reconciliation

18. It is prescribed as an accounting standard in this statement that reporting entities display in a note to financial statements a reconciliation between the beginning and ending balances of the subsidy cost allowance for outstanding direct loans and the liability for outstanding loan guarantees reported in the entities' balance sheet.
19. During its discussions about the subsidy expense and subsidy reestimates, the Board held the view that it is not adequate or desirable to report annual subsidy expense and reestimates in an isolated fashion. The Board concluded that additional information is needed to provide a full picture about a credit program's performance. The Board believes that the reconciliation can be used as an effective vehicle to provide such information.
20. As explained in the March 1999 ED, an advantage of displaying the reconciliation is to show in one place the activities that affect the subsidy cost allowance or the loan guarantee liability. In addition to the subsidy expense and reestimates, which are based on projections of future cash flows, the reconciliation schedule also displays data on actual performance, such as fees received, loans written off, claim payments made to lenders, and foreclosed property, loans receivable, or other recoveries acquired during the reporting year. These actual performance data and the data on subsidy cost estimates would be a useful tool to begin assessing the actual performance of a reporting entity's lending or loan guarantee activities against its budget expectations.
21. The Board noted as another advantage that the reconciliation process would enhance credit agencies' internal control. To comply with the requirement, entities must make the subsidy data elements consistent, accurate, and thus reconcilable. In conjunction with credit agencies' loan monitoring systems, the reconciliation process can serve as a tool to foster a discipline in organizing data related to subsidy costs and performance in a systematic manner.
22. A majority of the respondents supported the Board's proposal for displaying the reconciliation. They believed that the reconciliation will provide useful information to Congress, program managers, and other users of financial statements. One respondent stated that once required as a part of the financial statements, the reconciliation will be subject to validation through audit and thus will become a reliable

source of information for those who make decisions and evaluate results for credit activities.

23. Several respondents, however, expressed disagreements or reservations about the proposed reconciliation. Some of them commented that compiling the reconciliation data would be a burdensome process. We believe that performing the reconciliation would initially require some staff training and computer programming. However, the effort will be worthwhile because the process will help agencies organize the necessary data in an orderly manner. When properly programmed, the reconciliation process can become a routine and systematic process. In fact the reconciliation requires no more data than those that are necessary in deriving the ending balances of the subsidy cost allowance and loan guarantee liability from their beginning balances of a reporting period. Thus, all the data necessary for the reconciliation should be available and verifiable if the ending balances are accurate.
24. It should be noted that it is not unusual to require reconciliation in credit activities. In its Industry Guide No. 3, the Securities and Exchange Commission (SEC) requires bank holding companies to provide an analysis of the allowance of loan losses in their financial statements.⁴ The analysis is equivalent to the reconciliation of the subsidy cost allowance required in this statement. The SEC Guide requires that the beginning and ending balances of the allowance be reconciled with charge-offs (loans written off), recoveries, and additions charged to operations (equivalent to subsidy reestimates). The charges-offs and recoveries are displayed by type of loans (such as consumer installments, commercial, real estate, and lease financing, as so forth). A similar requirement is prescribed by the Financial Accounting Standards Board (FASB) in paragraph 20, FAS No. 114, as amended by FAS 118, for impaired loans accounted for on a present value basis:

For each period for which results of operations are presented, a creditor also shall disclose the activity in the total allowance for credit losses related to loans, including the balance in the

⁴*SEC Accounting Rules*, ¶ 8303, 1984 Commerce Clearing House, Inc. [Additional reference: Securities Act Guide 3 adopted in Release No. 34-12784, amended by Release Nos 33-6221, 33-6383, FR-11, FR-13 and FR-27]

allowance at the beginning and end of each period, additions charged to operations, direct write-downs charged against the allowance, and recoveries of amounts previously charged off. The total allowance for credit losses related to loans includes those amounts that have been determined in accordance with FASB Statement No. 5, Accounting for Contingencies, and with this Statement.

25. Some of those who disagreed with the reconciliation proposal recognized merits in reconciling subsidy cost allowance for direct loans and liability for loan guarantees, but doubted whether the reconciliation on an entity basis would provide useful information. They pointed out that the programs their agencies administer vary in characteristics and subsidy rates, and that the reconciliation at the entity level will aggregate the program data and, as a result, will not reveal the characteristics and operating results of individual programs.
26. The Board was aware that programs administered by an agency often differ in characteristics and subsidy rates. The Board agrees with the view that the entity-wide reconciliation in itself would not reveal variations in program performance. The Board thus decided to issue an exposure draft, soon after issuing this statement, to propose a display of a program-by-program reconciliation for major programs. Nevertheless the Board sees value in the entity-wide reconciliation itself. With respect to the subsidy cost allowance and the loan guarantee liability reported on an entity's balance sheet, the entity-wide reconciliation shows changes in those balances. Those changes indicate the entity's aggregate performance results for all the credit activities under the entity's management.
27. The Board considered two primary reasons for adopting the entity-wide reconciliation in this statement, rather than postpone it until the program-by-program reconciliation is proposed and considered. First, by making the entity-wide reconciliation effective as early as possible, agencies can begin to get their personnel and systems resources ready for implementing the requirement without further delay. Second, by requiring the display of the entity-wide reconciliation, it is likely that program-by-program reconciliation data would be available for users. This is based on the rationale that in order to display the entity level reconciliation, the reporting entity would normally first reconcile the balances of individual programs. If they do so, program managers as well as auditors will have access to the program reconciliation data to

validate the entity-wide reconciliation and to use the program-based data in program analysis and evaluation. If requested by Congress, special reports for any particular program can also be made available to Congress.

28. One respondent pointed out that loan guarantee programs sometimes acquire guaranteed loans for direct collection upon paying default claims for those loans. He asked whether the subsidy cost allowance of those loans should be reconciled in a separate schedule. Under credit reform accounting, guaranteed loans acquired by the loan guarantee program upon paying default claims are carried at their present value and the present value is reestimated annually before the loans are collected or written off. The amount of those loans and their allowance are reported in Note 7 in OMB Bulletin 97-01, *Form and Content of Agency Financial Statements*. Since the acquired loans do not represent a primary line of business for loan guarantee programs, the Board does not believe that a display of reconciliation for those acquired loans should be required.
29. One respondent asked whether the reconciliation requirement applies to pre-credit reform direct loans and loan guarantees as well as post-credit reform direct loans and loan guarantees. The Board considered the issue and concluded that the reconciliation requirement applies only to post-credit reform direct loans and loan guarantees, i.e., direct loan and loan guarantees obligated or committed after September 30, 1991. One of the principal objectives for the reconciliation requirement is to provide information that can be used to compare initial budget expectations with operating results. This is achievable with direct loans and loan guarantees that were obligated or committed after September 30, 1991, because under credit reform, budgeting and financial reporting for credit activities are performed on the same present value basis. This is not the case with pre-credit reform direct loans and loan guarantees.
30. However, aside from the basic objective discussed above, the other advantages of the reconciliation are valid for both pre and post-credit reform direct loans and loan guarantees. Those advantages include:
 - (a) revealing information on activities that affect the balances, and
 - (b) enhancing accounting integrity and internal control. Agencies are encouraged, but not required, to reconcile the direct loan allowance and loan guarantee liability balances for direct loans and loan guarantees obligated or committed prior to October 1, 1991. Since the

measurement bases differ between pre and post-credit reform direct loans and loan guarantees, agencies should use separate reconciliation schedules for pre and post-credit reform direct loans and loan guarantees.

Disclosing Subsidy Rates

31. A disclosure provision has been prescribed in this statement to require that reporting entities disclose, at the program level, the rates for the total estimated subsidy cost and the subsidy cost components in the current year's budget for the current year's cohorts. Each rate equals the amount of the total subsidy or a subsidy component divided by the amount of direct or guaranteed loans obligated in the cohort for the reporting year. The Board members believed that the budget subsidy rates for the reporting year are highly important because they represent budget expectations that reflect the most recent program characteristics.
32. The standard provides that reporting entities may use trend data to display significant fluctuations in a program's subsidy rates. To avoid excessive and purposeless presentation of historical data, the use of trend data should be limited to the subsidy rate for the total subsidy or for a subsidy component of a particular program that has experienced significant fluctuations in recent years. The presentation of trend data should be accompanied by analysis to explain causes of the fluctuations.
33. A majority of the respondents supported the proposal for disclosing the estimated subsidy rates for cohorts of the current year. The arguments for the proposal they presented include: (a) those subsidy rates estimated in the current year's budget "give the reader the most up-to-date information on cohorts as established by appropriation law," (b) those rates reflect the most recent program characteristics, and (c) the subsidy rates reported for a number of recent years can form a trend for comparison and analysis.
34. One respondent requested clarification for the phrase "in the current year's budget for the current year's cohorts." The required disclosure is for budget subsidy rates for the cohorts of the current reporting year, i.e., the year for which the financial reports are published. For example, in the financial reports for the 2001 fiscal year, the budget subsidy rates in the FY 2001 budget for the FY 2001 cohorts should be compiled and disclosed at the program level. The standard does not

require disclosure of subsidy rates for cohorts of previous years, although some of the cohorts may continue to disburse loans during the current reporting year. However, as provided in the standard, entities may use trend data to display significant fluctuations in subsidy rates over a number of the most recent years.

35. Those who were opposed to the disclosure for subsidy rates presented the following arguments: (a) budget subsidy rates for all credit programs are published in the *Federal Credit Supplement to the Budget of the U.S. Government*, and it is unnecessary to duplicate the same data in financial reports, (b) the inclusion of budget subsidy rates in financial reports would appear to invite calculation of subsidy costs by applying the subsidy rates to disbursements, and such calculation could produce confusing results, and (c) the subsidy rates in the budget are estimated before all the data concerning the reporting year are available, and are subject to changes.
36. The Board was aware that the budget subsidy rates are published in the *Federal Credit Supplement to the Budget of the U.S. Government*. However, the inclusion of those subsidy rates in the financial reports will provide the reader of the financial statements with an easy access to the budget data. The Board was also aware that one cannot calculate the subsidy expense for the current year by applying the estimated subsidy rates of the current year cohorts to the amount of direct or guaranteed loans disbursed during the current year. Such calculation may give erroneous results because some of the loans disbursed during the current year may belong to previous years' cohorts. The disclosure of budget subsidy rates was initially proposed by the AAPC Credit Reform Accounting Task Force. When proposing the disclosure, the AAPC Credit Reform Accounting Task Force suggested that the disclosure be accompanied by a narrative explaining in conceptual terms how the total subsidy rate differs from the total subsidy expense recognized in the financial statements. The Board believes that it is necessary to have such a narrative to avoid confusion between the subsidy rates of the current year cohorts and the subsidy expense recognized for the current reporting year.
37. It is true that the estimated subsidy rates for a program in the current year's budget reflect budget expectations for that program, and do not reflect the program's operating results for the current reporting year. The actual performance of a program can be viewed from such data as subsidy reestimates, loans written off, default claims paid, and fees

received. One of the purposes for the disclosure of the budget subsidy rates is to provide an indication of budget expectations of the most recent cohorts.

38. The Board believes that the disclosure for the subsidy rates for the cohorts of the current reporting year will prove beneficial as they are important indicators for management's latest expectations reflecting the programs' current characteristics. The disclosure requirement is adopted because the advantages of the disclosure outweigh its disadvantages.

Disclosure And Discussion

39. The Board holds the view that merely reporting the figures for the subsidy expense and subsidy reestimates would not provide complete and understandable information to users of Federal agency financial reports. The Board believes that to make the figures meaningful, significant events and changes in assumptions underlying the cost estimates should be disclosed and their impact should be discussed. The disclosure and discussion should help explain the subsidy cost data. In other words, the Board believes that it is necessary to tell the stories behind the figures.
40. Reporting entities are required to provide a description of the programs that they administer and disclose at the program level the amounts of direct or guaranteed loans disbursed during the reporting year. This information would provide the reader with an indication of the programs' characteristics and the magnitude of their credit activities. With the information on amounts disbursed, analysts can calculate the subsidy expense, or one of its components, as a ratio to the amount of the loans disbursed and compare the ratios among programs or over time.
41. Reporting entities are required to disclose events and changes that have had a significant and measurable effect on subsidy costs. These would include changes in economic conditions and risk factors, changes in legislation and policies regarding direct loans or loan guarantees, and changes in methodologies and assumptions used in making subsidy estimates and reestimates. Credit agencies are also required to disclose and discuss events and changes that have occurred and are more likely than not to have a significant impact on subsidy rates, subsidy expense, and subsidy reestimates but the effects of which are not measurable at the reporting date. These

include events and changes that have occurred after the reestimation cut off date and will be taken into consideration in making reestimates for the following year. Reporting entities should discuss how those events and changes have or would have impacted the various components of subsidy expense, subsidy rates, and subsidy reestimates.

42. The Board noted in particular that changes in legislation and credit policies could significantly alter a program's characteristics and thus affect its subsidy rates. These changes include, for example, changes in borrowers' eligibility, the level of fees or interest rates charged borrowers, the maturity terms of loans, and the percentage of a private loan that is guaranteed. If such a change occurs during a reporting year, the reporting entity should disclose and explain the nature of the change and discuss its impact on program characteristics and its estimated subsidy rates.
43. Most respondents supported the Board proposal. They believed that to make the reported financial figures meaningful, significant events and changes in assumptions underlying those figures should be disclosed and their effect should be discussed. Some of the respondents provided examples of events that can affect default rates. For example, drought, flood, tornadoes, and other natural disasters may affect some regions or some sectors of the economy, and consequently, affect borrowers' ability to make loan payments. Those respondents also noted that changes in economic conditions, such as interest and employment rates, could also have a significant impact on credit risks and performance. Some of them stated that legislative and policy changes could have a direct impact on the costs and performance of certain affected programs. They contend that without disclosing those events and changes and discussing their impact, the reader cannot fully understand the financial figures, such as subsidy rates, expenses, and reestimates.
44. One respondent noted that the same type of disclosure and discussion that is now required for credit subsidies is not usually required for many other operating costs, such as employees salary, rent, and computer service costs. The respondent questioned why the disclosure and discussion for credit activities are more critical than other costs reported in the statement of net cost. To address this issue, we can provide at least two reasons for this difference. First, unlike salary, rent, or the costs of other services, the credit subsidy costs are

under a greater degree of uncertainty, as they are exposed to many risk factors external to the government. Many factors discussed in the March 1999 ED and by other respondents, such as changes in interest and employment rates and disastrous events, would cause the subsidy costs to vary from their estimates in the budget. Second, unlike most other cost items, the credit subsidy costs are reported in present values of future cash flows projected over the life of the underlying direct loans and loan guarantees. To a large extent, the reliability of the subsidy cost information depends on the factors considered in making the cash flow projections. The reliability is also affected by the quality of the agency's data and its estimation methodology. The narrative disclosure and discussion would help the user to understand the factors that cause significant changes in the subsidy costs during the reporting year, which do not usually occur in salary, rent, or other operating costs.

45. Two respondents, however, were opposed to the narrative disclosure and discussion requirement on the grounds that it would be burdensome for entities with varied programs to present the required information. These respondents may have come under a misperception about the disclosure and discussion requirement. They may have perceived that the standard would require an excessively detailed description of all the technical aspects of the subsidy estimation methodologies and assumptions, and an extensive analysis of all risk factors in the programs and even sub-programs administered by the reporting entity. Thus, they concluded the requirement is extremely burdensome. However, such detailed disclosure and discussion were not intended. It was stated in paragraph 50 of the March 1999 ED:

While the Board members believe that the proposed disclosure and discussion are necessary, they prefer that entity financial reports are not overwhelmed with detailed numbers and ratios that may overburden the reader of the financial reports. The Board members believe that to the extent possible, the narrative discussion should be written in non-technical language so that the average reader can understand the data and the explanations.

46. The primary emphasis of the disclosure and discussion requirement is on significant changes in subsidy rates and reestimates. The disclosure and discussion should be focused on events that have occurred and have caused those significant changes. In addition, the disclosure and discussion should also include events that have occurred and are more likely than not to have a significant impact on subsidy rates and

reestimates but the effects for which are not measurable at the reporting date.

47. Some respondents believed that the narrative disclosure and discussion should more appropriately belong to the Management Discussion and Analysis (MD&A) section of financial reports. The Board disagrees with this view. The narrative disclosure and discussion required in this statement should be specifically tailored to address credit subsidy activities. As such, it differs from the MD&A requirements in breadth, depth, and detail. The Board believes that the disclosure and discussion required in this statement belong in a note to financial statements, such as Note 7 in OMB Bulletin 97-01, *the Form and Content of Agency Financial Statements*, in which all the data on direct loan assets, loan guarantee liabilities, subsidy rates, subsidy expenses, and reestimates are reported. By including the narrative disclosure and discussion in the same note, the reader would find all the information in one place. However, this does not preclude entity management from including a discussion and analysis to highlight credit activities in MD&A, so long as entity management determines that such a discussion and analysis meets the MD&A requirements in SFFAS 15.
48. Audit efforts for information provided in a footnote to financial statements differ from those for information provided in MD&A. MD&A is regarded as required supplementary information (RSI) and is subject to less stringent audit than basic financial statements and their notes.⁵ The Board believes that program subsidy data should be reported in a note to agency financial statements because they are directly related to information reported in the financial statements. Those program subsidy data should be audited as basic financial information. Based on the preceding paragraph, it might appear that including the narrative disclosure and discussion in the same footnote with the subsidy data (instead of in MD&A) would expand the audit burden associated with credit subsidies. However, since the auditor already needs to test the reliability of the estimates and reestimates in

⁵See Statement of Recommended Accounting Standards No. 15, *Management Discussion and Analysis*, (April 1999) par. 18.

the context of auditing the basic program subsidy data⁶, the Board believes that there would be no substantial increase in audit burden from including the narrative disclosure and discussion in a footnote instead of in MD&A. In fact, the process of generating the required disclosure and discussion for the footnote should provide information on risk factors underlying the subsidy estimates and reestimates and thus should facilitate the audit of the basic subsidy data.

49. One respondent commented that there may not be a basis to audit future events and their effect disclosed in the narrative. The required disclosure is for events that have occurred, but does not include events that are anticipated to occur. Also, the provision does not require quantifying the effect of an event that has occurred but whose effects cannot be measured at the reporting date.

The Effective Date

50. In the March 1999 ED, it was proposed that the amendments be made effective for periods beginning after September 30, 1999. Two respondents requested that the effective date be made for periods beginning after September 30, 2000. They argued that many agencies were still having difficulties in implementing existing credit reform requirements and that the new requirements would require revisions in accounting procedures and systems. The CFO Council stated that many agencies are busy with resolving Y2K problems, and would not be able to initiate new systems changes until some time in year 2000.
51. There were arguments against postponing the effective date. First, the requirements prescribed in this statement do not require any new data. For example, the data needed for the reconciliation schedules should be in the system. Without that data, agencies could not report the ending balances of the subsidy cost allowance and the loan guarantee liability at the end of each fiscal year. Second, the proposed effective date, beginning with fiscal year 2000, provides adequate time because

⁶For example, Federal Financial Accounting and Auditing Technical Release No. 3, *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (July 1999), requires auditors to identify significant external and internal factors that may affect the credit subsidy estimates and reestimates. External factors include economic conditions, current political climate, and relevant legislation. Internal factors include the size of the agency's budget and accounting staff qualifications of key personnel, turnover of key personnel, and system capabilities.

financial statements for that year will be issued in early calendar year 2001.

52. On the other hand, the Board recognizes that staff training and computer re-programming may be necessary to implement the new requirements. Therefore, the Board considered and granted a delay for the effective date to periods beginning after September 30, 2000. However, the Board emphasizes that this should not be considered a precedent for postponing implementation of adopted accounting standards. The Board encourages early implementation of the standards.

Vote For Approval

53. The accounting standards prescribed in this statement are approved by the Board unanimously.

**Appendix B:
Illustrative
Reporting Formats**

The following two schedules illustrate the reconciliation between beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees.

A: Schedule for Reconciling Subsidy Cost Allowance Balances

Dollars in thousands

Beginning Balance, Changes, and Ending Balance	FY 2000	FY 2001
Beginning balance of the subsidy cost allowance	\$	\$
Add: subsidy expense for direct loans disbursed during the reporting years by component:		
(a) Interest subsidy costs		
(b) Default costs (net of recoveries)		
(c) Fees and other collections		
(d) Other subsidy costs		
Total of the above subsidy expense components		
Adjustments:		
(a) Loan modifications		
(b) Fees received		
(c) Foreclosed property acquired		
(d) Loans written off		
(e) Subsidy allowance amortization		
(f) Other		
Ending balance of the subsidy cost allowance before reestimates		
Add or subtract subsidy reestimates by component		
(a) Interest rate reestimate		
(b) Technical/default reestimate		
Total of the above reestimate components		
Ending balance of the subsidy cost allowance		

B: Schedule for Reconciling Loan Guarantee Liability Balances

Dollars in thousands

Beginning Balance, Changes, and Ending Balance	FY 2000	FY 2001
Beginning balance of the loan guarantee liability	\$	\$
Add: subsidy expense for guaranteed loans disbursed during the reporting years by component:		
(a) Interest subsidy costs		
(b) Default costs (net of recoveries)		
(c) Fees and other collections		
(d) Other subsidy costs		
Total of the above subsidy expense components		
Adjustments:		
(a) Loan guarantee modifications		
(b) Fees received		
(c) Interest supplements paid		
(d) Foreclosed property and loans acquired		
(e) Claim payments to lenders		
(f) Interest accumulation on the liability balance		
(g) Other		
Ending balance of the loan guarantee liability before reestimates		
Add or subtract subsidy reestimates by component:		
(a) Interest rate reestimate		
(b) Technical/default reestimate		
Total of the above reestimate components		
Ending balance of the loan guarantee liability		

**Appendix C: The
Accounting
Standards in
SFFAS No. 2**

See “Statement of Federal Financial Accounting Standards 2: Accounting for Direct Loans and Loan Guarantees” on page 205.

Appendix D:
Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Statement of Federal Financial Accounting Standards 19: Technical Amendments to Accounting Standards For Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2

Status

Issued	March 2001
Effective Date	For periods ending after September 30, 2002
Volume II References	Loans and Loan Guarantees (L60)
Interpretations and Technical Releases	TR 3 (Revised), Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i> TR 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>
Affects	SFFAS 2 and SFFAS 18
Affected by	None.

Summary

In this Statement the Board adopts a number of technical amendments to certain portions of the Statement of Federal Financial Accounting Standards 2, Accounting for Direct Loans and Loan Guarantees (SFFAS 2), which was issued in August 1993.

The technical amendments serve the following purposes:

- (A) Clarify that the cash flow discount method used in the accounting standards prescribed in SFFAS 2 is consistent with the method required in the Federal Credit Reform Act of 1990, as amended in July 1997.
- (B) Clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS 2*.
- (C) Clarify the measurement principle for the default costs of direct loans and loan guarantees.

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Introduction

Background and Purposes

1. In this Statement the Board adopts a number of technical amendments to certain portions of the Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan Guarantees* (SFFAS No. 2), which was issued in August 1993. These amendments were proposed for public comment in an Exposure Draft (ED) issued in May 2000. The title of that ED is “*Credit Program Reconciliation and Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statements of Federal Financial Accounting Standards No. 2 and No. 18.*” (Hereinafter the ED is referred to as the May 2000 ED.)
2. The technical amendments serve the following purposes:
 - (A) Clarify that the cash flow discount method used in the accounting standards prescribed in SFFAS No. 2 is consistent with the method required in the Federal Credit Reform Act of 1990, as amended in July 1997.
 - (B) Clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees in SFFAS No. 2.*
 - (C) Clarify the measurement principle for the default costs of direct loans and loan guarantees.
3. The Board received nine responses to the ED. All of the respondents were in support for the technical amendments, except for two respondents who commented on the proposed technical amendments related to the measurement of default costs. Based on the comments, the Board made a minor modification to the proposed measurement of default costs for direct loans. This modification is discussed in this Statement’s Appendix A, Basis for Conclusions.
4. In addition to the technical amendments, the Board proposed a standard in the May 2000 ED, requiring that entities display a program-by-program reconciliation for major credit programs between the

beginning and ending balances of subsidy cost allowance for direct loans and the liability for loan guarantees. The Board decided not to adopt that proposal based on cost-benefit considerations.

Effective Date 5. The technical amendments adopted in this Statement are effective for periods beginning after September 30, 2002. Early implementation of the amendments is encouraged.

Technical Amendments To SFFAS No. 2

Cash Flow Discount Method 6. The amendments in (a) and (b) below are made to clarify that the accounting standards in SFFAS No. 2 are consistent with the cash flow discount method required by the amendment enacted in July 1997 to the Federal Credit Reform Act of 1990. Sec. 502 (5)(E) of the Act, as amended, provides that “In estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the direct loan or loan guarantee for which the estimate is being made.”

(a) In paragraph 24, SFFAS No. 2, the phrase “with a similar maturity term” is changed to “with similar maturity to the cash flows.”

(b) In footnotes 3, 4, 6, and 7, SFFAS No. 2, the phrase “the remaining maturity” is replaced with the phrase “the remaining cash flows.”

Effective Interest Rate 7. The following amendments are made to clarify that the effective interest rate of a cohort of direct loans or loan guarantees is the interest rate adjusted for the interest rate re-estimate, as defined in paragraph 9(A), SFFAS No. 18. The adjusted rate should be used for amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure.

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- (a) In paragraph 30, SFFAS No. 2, the first sentence is changed to:

“The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was used to calculate the present value of the direct loans when the direct loans were disbursed, after adjusting for the interest rate re-estimate.”

- (b) In paragraph 31, SFFAS No. 2, the first sentence is changed to:

“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.”

- (c) In paragraph 46, SFFAS No. 2, the phrase in the parentheses is changed to “the rate that was originally used to calculate the present value of the direct loans, when the direct loans were disbursed, after adjusting for the interest rate re-estimate.”

- (d) In paragraph 50, SFFAS No. 2, the phrase in the parentheses is changed to “the rate that was originally used to calculate the present value of the liability, when the guaranteed loans were disbursed, after adjusting for the interest rate re-estimate.”

- (e) In paragraphs 57 and 59, SFFAS No. 2, the words “adjusted for the interest rate re-estimate” are added immediately after the words “the original discount rate.”

Measuring Default Costs 8. Paragraph 27 in SFFAS No. 2 is replaced with the following two paragraphs:

- (a) The default cost of direct loans results from projected deviations by the borrowers from the payment schedules for principal, interest, and fee payments in the loan contracts. However, the measurement of default costs does not include prepayments. The default cost is measured at the present value of projected payment deviations due to defaults minus projected net recoveries. Projected net recoveries include the amounts that would be collected from borrowers at a later date or the proceeds

from the sales of acquired assets minus the costs of foreclosing, managing, and selling the assets.

- (b) The default cost of loan guarantees results from paying lenders' claims upon default of the guaranteed loans. The default cost of loan guarantees is measured at the present value of projected payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus projected net recoveries as defined in paragraph 8(a).

Appendix A: Basis For Conclusions

Program-by-Program Reconciliation

9. In the May 2000 ED, the Board proposed a standard requiring that entities display a program-by-program reconciliation for major credit programs between the beginning and ending balances of the subsidy cost allowance for direct loans and the liability for loan guarantees. Nine respondents to the ED commented on the proposal. Five of them supported the proposal and the remaining four were opposed to the proposed standard.
10. Those who supported the proposal believed that the display of a program-by-program reconciliation would enhance disclosure for program costs and performance. One of the respondents said that the program-by-program reconciliation would reveal actual program performance information, such as direct loans written off, default claims paid, fees received, and interest supplements paid. Reporting this kind of information on a program-by-program basis is not required by the existing standards. If the data were reported, they could be useful in analyzing a program's operating results and providing feedback to the program's budget expectations. Another respondent pointed out that when program data are aggregated, increases and decreases in program costs would offset each other. Thus, without a display of program-by-program reconciliation, entity-wide reconciliation alone would not disclose variations in program performance.
11. Among those who were opposed to the proposal, the Chief Financial Officer (CFO) of US Department of Agriculture (USDA) said that the proposed standard was unnecessary because USDA has reported subsidy costs by credit areas. The USDA CFO and several other respondents expressed their concern that the proposed display of program-by-program reconciliation would make the disclosure too lengthy and complex and thus reduce its information value to the users of general-purpose financial reports.
12. After considering the comments, the Board decided not to adopt the proposed standard. The Board concluded that SFFAS No. 2 and SFFAS No. 18 already require sufficient program information.

Paragraph 32 in SFFAS No. 2, as amended by SFFAS No. 18, requires that entities disclose each program's interest rate re-estimates and technical/default re-estimates. More extensive disclosure is required in SFFAS No. 18. Paragraph 11(a) in SFFAS No. 18, for example, requires that entities provide a description of the characteristics of the programs that they administer. It also requires disclosure of the amount of direct or guaranteed loans disbursed for each program during the reporting year as well as each program's subsidy expense, and subsidy re-estimates. Paragraph 11(b) requires disclosure of each program's subsidy rates for direct loans and loan guarantees in the current year's cohort. Furthermore, paragraph 11(c) requires that reporting entities disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy re-estimates. The Board believes that in the process of producing the program-based information required by paragraph 11(c), an entity will naturally describe important changes in the actual performance of its credit programs; e.g., default claims paid, loans written off, etc. Thus, the Board concluded that the program-based disclosure and discussion required by the existing standards should provide sufficient information about credit activities at the program level. In addition, although the incremental cost of producing the program-based reconciliation would be quite small for most agencies, the Board believes that requiring the display of program-based reconciliation would add length and complexity to the financial reports that are already detailed and complex. As a result of these benefit and cost considerations, the Board concluded that requiring the display of a program-by-program reconciliation was not justified.

Technical Amendments

13. The Board adopted three groups of technical amendments to SFFAS No. 2. The first group affects paragraph 24 and footnotes 3, 4, 6, and 7 of SFFAS No. 2. These amendments clarify that the accounting standards are consistent with the cash flow discount method required by the Federal Credit Reform Act of 1990, as amended in July 1997.¹ As required in Section 502 (5)(E) of the Act, the amended standards

¹ Office of Management and Budget (OMB) has implemented the amendment in Circular A-11, Preparation and Submission of Budget Estimates, July 1999 and in its recent release of a new credit subsidy calculator.

require using as the discount rate the average interest rate on Treasury securities of similar maturity to the cash flows of a direct loan or loan guarantee. None of the respondents to the ED objected to these amendments.

14. The second group of amendments affects paragraphs 30, 31, 46, 50, 57, and 59 of SFFAS No. 2. These amendments are related to interest rate re-estimates. The amendments clarify that the effective interest rate of a cohort of direct loans and loan guarantees is the interest rate adjusted by the interest rate re-estimate, as defined in paragraph 9(a), SFFAS No. 18. The adjusted rate should be used for amortizing subsidy cost allowance, accruing and compounding interest on the liability for loan guarantees, determining the book value of modified direct loans and the book value of the liability for modified loan guarantees, and calculating the present value of assets acquired through foreclosure. None of the respondents to the ED objected to these amendments.
15. The third group of amendments, proposed in ED paragraphs 10(A) and 10(B), concerns the measurement of default costs discussed in paragraph 27, SFFAS No. 2. ED paragraph 10(A) addressed the default costs of direct loans. The proposed amendment in that paragraph would include the effect of short-term delinquencies in the “other costs” category, rather than the “default costs” category.
16. The USDA CFO and IG objected to the exclusion of short-term delinquencies from default costs. They said that the Commodity Credit Corporation (an USDA unit) uses the Inter-Agency Country Risk Assessment System (ICRAS) to estimate default costs. The ICRAS, used for lending to foreign countries, includes short-term delinquencies in measuring default costs. Thus, the proposed amendment would create a difference from that practice.
17. The Board understands that practices differ among lending institutions in treating delinquencies. They may or may not regard a payment delay within a certain time frame as default. The Board is of the view that the variation would not distort the measurement of credit subsidy costs, if each practice is followed consistently. In this regard, it is better that the accounting standard leaves some leeway for the agencies that are responsible for developing subsidy estimate models and methodologies. Thus, the Board deleted the words related

to “delinquencies” in paragraph 8(a) of this Statement on default costs of direct loans.

18. Paragraph 8(b) of this Statement addressed the measurement of default costs for loan guarantees. The paragraph reads as follows:

The default cost of loan guarantees results from paying lenders’ claims upon default of the guaranteed loans. The default cost of loan guarantees is measured at the present value of projected payments to lenders required by the guarantee, plus uncollected fees, minus interest supplements not paid as the result of the default, and minus projected net recoveries as defined in paragraph 10(A).

19. The USDA CFO commented on the requirement for including uncollected fees and “interest supplements not paid” in measuring default costs. The USDA CFO stated that although those cash flow components are specified in the OMB credit subsidy calculator, OMB would give agencies flexibility in implementation with regard to those cash flow components. The USDA CFO pointed out that realigning those cash flow components might entail substantial changes in agencies’ credit subsidy models. She also indicated problems with private lender restrictions and workload increases. She suggested that agencies be allowed flexibility to determine whether those cash flow components are to be included in default costs.
20. The Board believes the amended standard provides a sound methodology for measuring the default costs for loan guarantees. Uncollected fees are a direct result of default itself and therefore should be included in measuring the default costs. The interest supplements not paid are also a direct result of defaults. When a guaranteed loan is in default, the government pays the default claim to the lender and stops paying interest supplement for that loan. Thus, the interest supplements that are saved due to default should be subtracted from the default costs. The Board concluded that the categorization of these cash flow components should be uniform across the government so that they can be comparable among programs. However, as discussed in the following paragraph, the Board has decided to delay the implementation of the technical amendments for one year. This delay should help resolve some of the problems raised by the USDA CFO.

Effective Date

21. The proposed effective date for the technical amendments was for periods beginning after September 30, 2001, which means FY 2002. The Board realized that that the subsidy expenses to be reported for FY 2002 would be based on the budget submission for that year. However, there would not be sufficient time to implement the amendments for the FY 2002 budget. Therefore, the Board decided to make the effective date for periods beginning after September 30, 2002, and the Board encourages earlier implementation.

Board Approval

23. This Statement was approved by the Board with a vote of eight members in approval of its issuance. One member submitted a written dissent, which is available for inspection at the FASAB office.

Appendix B: The Accounting Standards In SFFAS No. 2

Presented in this Appendix are the standards originally prescribed in SFFAS No. 2. The paragraphs and their numbers reproduced in this Appendix are the same as those that appear in SFFAS No. 2, and are presented here for reference purposes only. The bolded words, paragraphs, and footnotes are those that have been amended by SFFAS No. 18² or by this Statement.

Explanation

21. These standards concern the recognition and measurement of direct loans, the liability associated with loan guarantees, and the cost of direct loans and loan guarantees. The standards apply to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category.

Accounting Standards Post-1991 Direct Loans

22. Direct loans disbursed and outstanding are recognized as assets at the present value of their estimated net cash inflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recognized as a subsidy cost allowance.

Post-1991 Loan Guarantees

23. For guaranteed loans outstanding, the present value of estimated net cash outflows of the loan guarantees is recognized as a liability. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.

Subsidy Costs of Post-1991 Direct Loans and Loan Guarantees

24. For direct or guaranteed loans disbursed during a fiscal year, a subsidy expense is recognized. The amount of the subsidy expense equals the present value of estimated cash outflows over the life of the loans minus the present value of estimated cash inflows, discounted at the interest rate of marketable Treasury securities with a **similar maturity term** applicable to the period during which the loans are

² SFFAS No. 18 amended paragraph 32 in SFFAS No. 2.

disbursed (hereinafter referred to as the applicable Treasury interest rate).

25. For the fiscal year during which new direct or guaranteed loans are disbursed, the components of the subsidy expense of those new direct loans and loan guarantees are recognized separately among interest subsidy costs, default costs, fees and other collections, and other subsidy costs.
26. The interest subsidy cost of direct loans is the excess of the amount of the loans disbursed over the present value of the interest and principal payments required by the loan contracts, discounted at the applicable Treasury rate. The interest subsidy cost of loan guarantees is the present value of estimated interest supplement payments.
27. **The default cost of direct loans or loan guarantees results from any anticipated deviation, other than prepayments, by the borrowers from the payments schedule in the loan contracts. The deviations include delinquencies and omissions in interest and principal payments. The default cost is measured at the present value of the projected payment delinquencies and omissions minus net recoveries. Projected net recoveries include the amounts that would be collected from the borrowers at a later date or the proceeds from the sale of acquired assets minus the costs of foreclosing, managing, and selling those assets.**
28. The present value of fees and other collections is recognized as a deduction from subsidy costs.
29. Other subsidy costs consist of cash flows that are not included in calculating the interest or default subsidy costs, or in fees and other collections. They include the effect of prepayments within contract terms.

Subsidy Amortization and Reestimation

30. **The subsidy cost allowance for direct loans is amortized by the interest method using the interest rate that was originally used to calculate the present value of the direct loans when the direct loans were disbursed.** The amortized amount is recognized as an increase or decrease in interest income.

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31. **Interest is accrued and compounded on the liability of loan guarantees at the interest rate that was originally used to calculate the present value of the loan guarantee liabilities when the guaranteed loans were disbursed.** The accrued interest is recognized as interest expense.
 32. **The subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the reestimation should take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries. Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates should be recognized as a subsidy expense (or a reduction in subsidy expense). Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required.**

Criteria for Default Cost Estimates

33. The criteria for default cost estimates provided in this and the following paragraphs apply to both initial estimates and subsequent reestimates. Default costs are estimated and reestimated for each program on the basis of separate cohorts and risk categories. The reestimates take into account the differences in past cash flows between the projected and realized amounts and changes in other factors that can be used to predict the future cash flows of each risk category.
34. In estimating default costs, the following risk factors are considered: (1) loan performance experience; (2) current and forecasted international, national, or regional economic conditions that may affect the performance of the loans; (3) financial and other relevant characteristics of borrowers; (4) the value of collateral to loan balance; (5) changes in recoverable value of collateral; (6) newly developed events that would affect the loans' performance; and (7) improvements in methods to reestimate defaults.
35. Each credit program should use a systematic methodology, such as an econometric model, to project default costs of each risk category. If

individual accounts with significant amounts carry a high weight in risk exposure, an analysis of the individual accounts is warranted in making the default cost estimate for that category.

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

Revenues and Expenses

37. Interest accrued on direct loans, including amortized interest, is recognized as interest income. Interest accrued on the liability of loan guarantees is recognized as interest expense. Interest due from Treasury on uninvested funds is recognized as interest income. Interest accrued on debt to Treasury is recognized as interest expense.
38. Costs for administering credit activities, such as salaries, legal fees, and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees.

Pre-1992 Direct Loans and Loan Guarantees

39. The losses and liabilities of direct loans obligated and loan guarantees committed before October 1, 1992, are recognized when it is more likely than not that the direct loans will not be totally collected or that the loan guarantees will require a future cash outflow to pay default claims. The allowance of the uncollectible amounts and the liability of loan guarantees should be reestimated each year as of the date of the financial statements. In estimating losses and liabilities, the risk factors discussed in the previous section should be considered. Disclosure is made of the face value of guaranteed loans outstanding and the amount guaranteed.
40. Restatement of pre-1992 direct loans and loan guarantees on a present value basis is permitted but not required.

Modification of Direct Loans and Loan Guarantees

41. The term modification means a federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans, or the liability of loan guarantees.
42. Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Existing contracts may be altered through such means as forbearance, forgiveness, reductions in interest rates, extensions of maturity, and prepayments without penalty. Such actions are modifications unless they are considered reestimates, or workouts as defined below, or are permitted under the terms of existing contracts.
43. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. Examples include a new method of debt collection prescribed by law or a statutory restriction on debt collection.
44. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms. Workouts are actions taken to maximize repayments of existing direct loans or minimize claims under existing loan guarantees. The expected effects of workouts on cash flows are included in the original estimate of subsidy costs and subsequent reestimates.

A. Modification of Direct Loans

45. With respect to a direct or indirect modification of pre-1992 or post-1991 direct loans, the cost of modification is the excess of the pre-modification value³ of the loans over their post-modification

³ The term "pre-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to **the remaining maturity** of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

value⁴. The amount of the modification cost is recognized as a modification expense when the loans are modified.

46. When post-1991 direct loans are modified, their existing book value is changed to an amount equal to the present value of the loans' net cash inflows projected under the modified terms from the time of modification to the loans' maturity and discounted at the original discount rate (**the rate that was originally used to calculate the present value of the direct loans, when the direct loans were disbursed**).
47. When pre-1992 direct loans are directly modified, they are transferred to a financing account and their book value is changed to an amount equal to their post-modification value. Any subsequent modification is treated as a modification of post-1991 loans. When pre-1992 direct loans are indirectly modified, they are kept in a liquidating account. Their bad debt allowance is reassessed and adjusted to reflect amounts that would not be collected due to the modification.
48. The change in book value of both pre-1992 and post-1991 direct loans resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. Any difference between the change in book value and the cost of modification is recognized as a gain or loss. For post-1991 direct loans, the modification adjustment transfer⁵ paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

⁴ The term "post-modification value" is the present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to **the remaining maturity** of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate).

⁵ OMB instructions provide that if the decrease in book value exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the decrease in book value, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

B. Modification of Loan Guarantees

49. With respect to a direct or indirect modification of pre-1992 or post-1991 loan guarantees, the cost of modification is the excess of the post-modification liability⁶ of the loan guarantees over their pre-modification liability⁷. The modification cost is recognized as modification expense when the loan guarantees are modified.
50. The existing book value of the liability of modified post-1991 loan guarantees is changed to an amount equal to the present value of net cash outflows projected under the modified terms from the time of modification to the loans' maturity, and discounted at the original discount rate (**the rate that was originally used to calculate the present value of the liability when the guaranteed loans were disbursed**).
51. When pre-1992 loan guarantees are directly modified, they are transferred to a financing account and the existing book value of the liability of the modified loan guarantees is changed to an amount equal to their post-modification liability. Any subsequent modification is treated as a modification of post-1991 loan guarantees. When pre-1992 direct loan guarantees are indirectly modified, they are kept in a liquidating account. The liability of those loan guarantees is reassessed and adjusted to reflect any change in the liability resulting from the modification.
52. The change in the amount of liability of both pre-1992 and post-1991 loan guarantees resulting from a direct or indirect modification and the cost of modification will normally differ, due to the use of different discount rates or the use of different measurement methods. The difference between the change in liability and the cost of modification is recognized as a gain or loss. For post-1991 loan guarantees, the

⁶ The term "post-modification liability" is the present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to **the remaining maturity** of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate).

⁷ The term "pre-modification liability" is the present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to **the remaining maturity** of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate).

modification adjustment transfer⁸ paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

C. Sale of Loans

53. The sale of post-1991 and pre-1992 direct loans is a direct modification. The cost of modification is determined on the basis of the pre-modification value of the loans sold. If the pre-modification value of the loans sold exceeds the net proceeds from the sale, the excess is the cost of modification, which is recognized as modification expense.
54. For a loan sale with recourse, potential losses under the recourse or guarantee obligations are estimated, and the present value of the estimated losses from the recourse is recognized as subsidy expense when the sale is made and as a loan guarantee liability.
55. The book value loss (or gain) on a sale of direct loans equals the existing book value of the loans sold minus the net proceeds from the sale. Since the book value loss (or gain) and the cost of modification are calculated on different bases, they will normally differ. Any difference between the book value loss (or gain) and the cost of modification is recognized as a gain or loss.⁹ For sales of post-1991 direct loans, the modification adjustment transfer¹⁰ paid or received to offset the gain or loss is recognized as a financing source (or a reduction in financing source).

D. Disclosure

56. Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the discount rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification.

⁸ OMB instructions provide that if the increase in liability exceeds the cost of modification, the reporting entity receives from the Treasury an amount of "modification adjustment transfer" equal to the excess; and that if the cost of modification exceeds the increase in liability, the reporting entity pays to the Treasury an amount of "modification adjustment transfer" to offset the excess. (See OMB Circular A-11.)

⁹ If there is a book value gain, the gain to be recognized equals the book value gain plus the cost of modification.

¹⁰ See footnote No. 7 for an explanation for "modification adjustment transfer".

**Foreclosure of Post-1991
Direct and Guaranteed
Loans**

57. When property is transferred from borrowers to a federal credit program, through foreclosure or other means, in partial or full settlement of post-1991 direct loans or as a compensation for losses that the government sustained under post-1991 loan guarantees, the foreclosed property is recognized as an asset at the present value of its estimated future net cash inflows discounted **at the original discount rate**.
58. If a legitimate claim exists by a third party or by the borrower to a part of the recognized value of the foreclosed assets, the estimated amount of the claim is recognized as a special contra valuation allowance.
59. At a foreclosure of guaranteed loans, a federal guarantor may acquire the loans involved. The acquired loans are recognized at the present value of their estimated net cash inflows from selling the loans or from collecting payments from the borrowers, discounted **at the original discount rate**.
60. When assets are acquired in full or partial settlement of post-1991 direct loans or guaranteed loans, the present value of the government's claim against the borrowers is reduced by the amount settled as a result of the foreclosure.

Write-off of Direct Loans

61. When post-1991 direct loans are written off, the unpaid principal of the loans is removed from the gross amount of loans receivable. Concurrently, the same amount is charged to the allowance for subsidy costs. Prior to the write-off, the uncollectible amounts should have been fully provided for in the subsidy cost allowance through the subsidy cost estimate or reestimates. Therefore, the write-off would have no effect on expenses.

Statement of Federal Financial Accounting Standards 20: Elimination of Certain Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7, Accounting for Revenue and Other Financing Sources

Status

Issued	September 2001
Effective Date	For periods ending after September 30, 2000
Volume II References	Revenue (R60)
Interpretations and Technical Releases	None.
Affects	SFFAS 7
Affected by	None.

Summary

Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*, became effective in fiscal year 1998 and included detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. The two entities collecting the vast majority of federal taxes are the Internal Revenue Service (IRS) and the U.S. Customs Service (Customs).

The Board is issuing this standard to rescind paragraph 65.2 of SFFAS 7. Absent very detailed explanations, the provisions of paragraph 65.2 could result in information being given to readers of the financial statements that they might misinterpret. The Board believes that paragraph 65.2 would not accomplish what it purports to accomplish, and would impose costs unnecessarily on both the preparer and auditor without a significant benefit. The Board's reasoning is explained more fully in Appendix A, Basis for Conclusions.

This amendment is effective for periods beginning after September 30, 2000.

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Introduction

Purpose

1. This standard rescinds paragraph 65.2 of Statement of Federal Financial Accounting Standards (SFFAS) 7 and makes other conforming changes.

Background

2. SFFAS 7 became effective in fiscal year 1998 and included, along with other provisions, detailed provisions that apply to entities collecting taxes on behalf of the Federal Government. Paragraph 65.2 of that standard required disclosure of “revenue-related transactions affecting the beginning and end-of-period balances of accounts receivables, accounts payable for refunds, and the allowance for uncollectible amounts.”
3. Subsequent to the issuance of the standard questions arose as to the usefulness of the information as well as to the practicality of producing it. After discussing the issues and options, the Board issued, in November 1998, an exposure draft of a standard rescinding paragraph 65.2. Ultimately, the Board agreed that more study was needed, and in January 1999 it deferred the effective date of paragraph 65.2 until October 1, 2000 (SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures*).
4. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7*. Based on comments received and further consideration, the Board is now rescinding paragraph 65.2.

Effective Date

5. This amendment is effective for periods beginning after September 30, 2000.

Accounting Standard

6. Paragraph 65.2 of SFFAS 7 is repealed and rescinded.
7. Other conforming changes:

-
- a. The last sentence of paragraph 107 of SFFAS 7 is changed to delete “65.2 and” from the parenthesis.
 - b. The last sentence of footnote 41, paragraph 187.1 of SFFAS 7 is changed to delete “in its disclosures required by para. 65.2”.

Appendix A: Basis For Conclusions

8. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
9. The Board issued an exposure draft in November 1998 proposing to rescind paragraph 65.2. Comments were received during a minimal comment period that ended December 12, 1998. In January 1999, the Board deferred the effective date of paragraph 65.2, SFFAS 7, until October 1, 2000.¹
10. In December 1998, the Board agreed that further study was needed regarding the relevance of the information discussed in paragraph 65.2. Additionally, the Board was concerned about the relatively short exposure period (approximately 30 days) for the ED. The Board decided to defer the effective date for implementing paragraph 65.2 and revisit the issue of eliminating the requirement at a later date.
11. Following the decision to defer the disclosure requirement, the Board did not take up research on the issue immediately. In December 1999, the Board reviewed its agenda and weighed whether it should devote scarce resources to this issue or simply allow the provisions of paragraph 65.2 to take effect for fiscal year 2001 financial statements. To assist in making this decision, the Board sent a letter to the Internal Revenue Service (IRS) asking what additional information might be available to aid the Board in considering the issue.
12. The IRS responded with additional information based on its two additional reporting years' experience with SFFAS 7 requirements. In addition, the IRS provided a briefing to the Board regarding its collections process and systems modernization. The IRS renewed the request that the Board rescind the provisions of paragraph 65.2. Its auditor, the General Accounting Office, supported this rescission.

¹ SFFAS 13, *Deferral of Paragraph 65.2 – Material Revenue-Related Transactions Disclosures, Amending SFFAS 7 Accounting for Revenue and Other Financing Transactions*, January 1999.

13. In November 2000, the Board issued a second exposure draft, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs, and Others, Amending SFFAS 7*, that proposed to eliminate paragraph 65.2. Because of the interest in the relevance of this information, the Board mailed copies to potential users, for example, Congresspersons and staff directors of key committees. The Board received comment letters on the exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)
Users, academics, others		2
Auditors	2	1
Preparers and financial managers	4	

Responses to the Exposure Draft

14. The respondents were closely divided with the majority supporting the proposed elimination of paragraph 65.2. It is important to note that the Board did not rely on the number in favor or opposed to a given position. Information about the majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The Board summarizes the respondents' arguments below.

Respondents Supporting the ED

15. Several respondents stated that paragraph 65.2 disclosures would not be useful, and could be misleading, to general purpose readers. A respondent stated that any attempt to reconcile the elements required by paragraph 65.2 could be misleading due to timing differences between assessments and collections and the definitions of revenue receipts and taxes receivable.
16. Some respondents said that the IRS currently provides sufficient detailed information about federal tax revenues, unpaid assessments, and refunds in its annual financial report through footnote disclosures, supplementary information and in its management's discussion and analysis (MD&A). Other respondents said that the disclosure requirements of paragraph 65.2 far exceed what should be required in general purpose financial statements. Another respondent concurring with the elimination of paragraph 65.2 stated that FASAB clearly documented its case in the ED's basis for conclusions.

Respondents Opposing the ED

17. Other respondents had a different view. One respondent stated that the disclosure in SFFAS 7 was intended to overcome some of the practical limitations of the tax collection system and make the tax revenue recognition closer to what would be reported with fuller accrual accounting. He submitted that the information required in paragraph 65.2 is relevant and useful in assessing the efficiency and effectiveness of the tax system, not merely the administrative practices, and can be explained satisfactorily so as not to be misleading.
18. Several respondents stated that insufficient evidence has been offered regarding the lack of relevance and understandability of the information to warrant eliminating the paragraph 65.2 disclosures, and doing so would weaken SFFAS 7. These respondents recommended extending the deferral period for the standard, further research, and a hearing, as necessary, prior to the issuance of a final standard. One respondent stated that the ED did not convincingly explain why the information called for in paragraph 65.2 is so complex that it could not be clearly explained. The respondent stated that SFFAC 1, par. 158, provides that general purpose financial reports should not exclude essential information merely because it is difficult to understand or because some report users choose not to use it.

The Board's Discussion

19. In conjunction with re-deliberating the issues presented in the exposure draft and carefully considering the respondents' comments, the Board notes that SFFAS 7 represents a major accomplishment in establishing federal accounting standards. SFFAS 7 presents standards for classifying, recognizing, and measuring resource inflows as well as concepts for financial reporting and makes other significant contributions. Many provisions of that statement are now fundamental to federal accounting. However, the Board believes that paragraph 65.2 of SFFAS 7 is flawed because the information required therein might be misinterpreted, would not accomplish what it purports to accomplish, and would be difficult to produce.

Information that Could Be Misinterpreted

20. Paragraph 65.2 requires disclosure of information about the beginning and ending balances of accounts receivable and related accounts, as well as material types of revenue transactions that relate to the collecting entity's custodial responsibilities. The minimum information required would include "assessments by the entity," "penalties," "interest," and "abatements." In the two exposure drafts

on this issue (November 1998 and November 2000) the Board has discussed the complexity of the assessment and abatement process. The Board has discussed the various IRS-initiated tax collection actions, including compliance assessments; the enforcement work-in-process status of the assessment database; the possible timing difference between the period to which the tax relates, the eventual assessment of the tax and penalties and interest, and the final collection or abatement of the assessment; and other complicating factors. Many assessments, penalties, and interest are made for enforcement purposes, are often overstated due to incomplete information, and are subject to change based on receipt of additional information from the taxpayer. Thus, they do not always precede a receivable² in an accounting sense. The Board believes that the user could misinterpret assessment reporting because increases or decreases in assessments do not lead necessarily to increases or decreases in receivables or revenue. Further, developing meaningful categories of assessments that would permit a user to analyze whether enforcement assessments are likely to lead to revenues would not be cost-beneficial when one considers the remaining reporting required under SFFAS 7 as amended.

21. The Board also has discussed the complications of the abatement process. Abatement is a reduction or cancellation of an assessed tax. Abatements are made for myriad reasons and in some cases there is no correlation between the original assessment and the final reason for the abatement. For example, taxpayers can carry back losses to prior years and reduce prior year taxes that were correctly assessed by the IRS. Such reductions are classified as abatements but are not the same as abatements where the tax assessment itself was in error.
22. Moreover, taxpayers also file amended returns that can require abatement of the original amount they reported, including taxpayer requests to abate particular types of penalty assessments due to reasonable causes. For example, during 1998 a new law required the IRS to disallow certain dependents and credits claimed if the taxpayer did not include a social security number for a dependent child or a taxpayer identification number for a child-care provider. In each case

²Per SFFAS 7, paragraph 53, accounts receivable should be recognized when a collecting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets through its established assessment process to the extent the amount is measurable.

the IRS posted an assessment, accrued penalties and interest pending provision of the information, and subsequently abated the assessment when the taxpayer provided the required verification. This change in law increased the total assessments, interest, penalties, and abatements to enforce a reporting requirement rather than to collect additional tax revenue. One could be misled since both assessments and abatements were “overstated” in the sense that it was anticipated at the time of assessment that, in the majority of cases, the assessment would be abated.

23. There are many different reasons for abatements with varying transactions potentially covering 10 years of assessments, each affecting the balances to be disclosed under paragraph 65.2. The Board believes that reporting on total assessments, including penalties and interest thereon, and abatements could be misinterpreted in the context of disclosures purporting to be transactions affecting the beginning and ending balances of accounts receivable and related accounts. Moreover, the Board believes that attempts to reconcile the elements required in paragraph 65.2 could be misinterpreted due to timing differences between assessments and collections and the definitions of revenue receipts and taxes receivable.
24. The Board concludes that the paragraph 65.2 information is not relevant for reconciling the beginning and ending balances of accounts receivable and related accounts, which paragraph 65.2 purports to do. Some of the required information is beyond the scope of those accounts since activity does not result in or relate to revenue or receivables, precedes the recognition of taxes receivable, or relates solely to tax administration or enforcement.
25. When considering whether to retain paragraph 65.2, the Board considered the materiality of taxes receivable. The IRS’ taxes receivable are not large in relation to annual tax revenue. For FY2000, approximately \$20 billion in IRS receivables represent three days of collections.

Other Information Required

26. The Board calls attention to other SFFAS 7 paragraphs and to other FASAB standards that require disclosures and supplemental information that the Board believes accomplish the objectives of SFFAS 7 as stated in paragraph 187.1 and elsewhere. Paragraph 65.1 requires disclosure of factors affecting collectability and timing of categories of accounts receivable and the amounts involved.

Paragraph 65.3 requires disclosure of cumulative cash collections and refunds by tax year and tax type. Paragraph 67 requires supplemental information about the estimated realizable value of compliance assessments and pre-assessment work-in-process; about other claims for tax refunds that are not yet accrued but are likely to be accrued when administrative actions are completed; and, about the amount of assessments that the entity still has statutory authority to collect but that have been written off and thus excluded from accounts receivable. SFFAS 15, *Management's Discussion and Analysis*, requires discussion, among other things, of performance goals, objectives, results, systems, controls, and legal compliance.

Conclusion

27. The Board actively sought comments from potential users. In addition to the FASAB distribution list, the Board sent the ED to all those who had commented on the prior ED of November 1998 and to potential decision-makers, including especially House and Senate committees and sub-committees. Also, in setting February 16, 2001, as the cut-off date for comments, the Board provided an extended period for respondents to submit comments. Despite the Board's efforts to reach users the response to the ED did not demonstrate a demand from users to have the information. Only one respondent said the information was useful and necessary. Other respondents who oppose eliminating paragraph 65.2 at this time said that the Board did not offer enough evidence regarding relevance and understandability to warrant eliminating paragraph 65.2, not that they themselves found it useful or relevant and for what purposes. Due to the cost of the information, the availability of other information on this topic, the requests from the preparer and auditor communities, and lack of a response from users of the information, the Board does not believe the paragraph should be retained.
28. The Board believes that sufficient evidence has been produced to conclude that the information required by paragraph 65.2 could be misinterpreted by users of general purpose financial statements and that it does not accomplish what it purports to accomplish. The Board does not exclude essential information merely because it is difficult to understand or because some report users choose not to use it. In this instance, however, the complexity of the tax collection process in conjunction with the context of accounts receivable reconciliation renders paragraph 65.2 defective and, therefore, not relevant. The objective of SFFAS 7 is to tell users what is happening at the tax collection entities, and the Board believes the standard is achieving

this objective without paragraph 65.2, and that paragraph 65.2 could in fact be misinterpreted. This amendment of SFFAS 7 is limited to the problem of disclosures in paragraph 65.2 being misinterpreted.

Vote for Approval

29. The amendment of SFFAS 7 prescribed in this statement is approved by a vote of seven members in favor and one member dissenting (only eight members voted due to a vacancy on the Board). The dissent is available for review at the FASAB offices.

Appendix B:
Paragraph 65 of
SFFAS 7

65. Entities that collect taxes and duties should disclose the following relating to future cash flows, revenue-related transactions, and custodial responsibilities:

65.1 Accounts **receivable**. Factors affecting collectibility and timing of categories of accounts receivable and the amounts involved.

65.2 **Material revenue-related transactions.** Revenue-related transactions affecting the beginning and end-of-period balances of accounts receivable, accounts payable for refunds, and the allowance for uncollectible amounts should be disclosed. All material types of revenue transactions which relate to the custodial responsibilities of the collecting entities should be disclosed. The disclosure should be comprehensive enough to include as a minimum: self-assessments by taxpayers (or importers); assessments by the entity; penalties; interest; cash collections applied to taxpayer accounts and unapplied collections; refunds, refund offsets, and drawbacks; abatements; accounts receivable written off during the reporting period as uncollectible; and provisions made to the allowance for uncollectible amounts.

65.3 Cumulative **cash collections and refunds by tax year and type of tax.** Cash collections and refunds by tax year and type of tax should include cash collections and cash refunds for the reporting period and for sufficient prior periods to illustrate (1) the historical timing of tax collections and refunds, and (2) any material trends in collection and refund patterns. Sufficient prior periods for each type of tax are the periods which end when the statutory period for collection ends. Collecting entities may shorten these periods if evidence for prior tax years indicates that a shorter period would reflect at least 99 percent of the collectible taxes.

Statement of Federal Financial Accounting Standards 21: Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources

Status

Issued	October 2001
Effective Date	For periods ending after September 30, 2001
Volume II References	Revenue (R60)
Interpretations and Technical Releases	None.
Affects	SFFAS 7
Affected by	None.

Summary

This Statement amends the standard on Prior Period Adjustments contained in Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources* (SFFAS 7), which was issued in April 1996.

Paragraph 76 of SFFAS 7, entitled Prior Period Adjustments, addresses accounting changes and errors that affect prior period financial statements. It does not permit reporting entities, when presenting prior period financial statements for comparative purposes, to restate prior period financial statements to show the effect of the accounting errors.

The unforeseen result is that reporting entities that have material errors in their prior period financial statements are unable to present them for comparative purposes without creating both a dilemma for auditors and confusion for users. The dilemma for the auditors is that they would have to qualify their opinion on the prior period financial statements whether or not they had been restated. If prior period statements were presented that contained a material error, auditors would have to qualify their opinion. On the other hand, if prior period statements were presented and balances had been corrected for an error, auditors would still have to qualify their opinion because such restatement would not be in accordance with the existing standard. The confusion for the user derives from the difficulty inherent in comparing the financial statements for two or more periods when the effect of the error is not shown in the prior periods' financial statements.

To correct this situation, the amendment requires that when material errors are discovered in prior period financial statements, all statements presented must be restated to correct the error.

The Board has retained the current requirement that prior period financial statements not be restated for changes in accounting principles, unless otherwise specified in the transition instructions section of a new FASAB standard. The language addressing the requirements, however, has been revised to improve clarity and to require certain disclosures.

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Introduction

1. Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources*, became effective for fiscal year 1998. It includes a section describing how reporting entities should handle prior period adjustments.
2. The Section on Prior Period Adjustments states:

76. Prior period adjustments should be limited to corrections of errors and accounting changes with retroactive effect, including those occasioned by the adoption of new federal financial accounting standards, and should be recognized and measured under applicable standards. Adjustments should be recognized as a change in cumulative results of operations (rather than as an element of net results of operations for the period). Prior period financial statements should not be restated for prior period adjustments recognized in the current period.
3. When SFFAS No. 7 was issued, the Board believed that having reporting entities restate prior period financial statements for prior period adjustments would create an unnecessary burden at a time when FASAB was still establishing a basic framework of standards.
4. However, disallowing restatement of prior period financial statements has had the effect of preventing reporting entities from presenting comparative financial statements when the prior period financial statements contain a material error that is discovered in the current period.
5. The Board has amended the standard to require that reporting entities restate prior period financial statements for material errors discovered in the current period, if such statements are provided for comparative purposes, and if the effect of the error would be material to the financial statements in either period.
6. The Board has chosen to retain the current methodology that prior period financial statements not be restated for changes in accounting principles, unless otherwise specified in the transition instructions section of a new FASAB standard. The language addressing the requirements, however, has been revised to improve clarity and to require certain disclosures.

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7. The language in the standard has also been revised to distinguish between corrections of errors and changes in accounting principles. A change in accounting principle should be identified as such and no longer reported as a prior period adjustment.

Effective Date

8. This amendment would be effective for periods beginning after September 30, 2001, with earlier implementation encouraged.

**Accounting
Standard**

9. Paragraph 76 of SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, Section Prior Period Adjustments, is superceded and replaced by Paragraphs 10 through 13 below.

Corrections of Errors

10. "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared."¹ When errors are discovered after the issuance of financial statements, and if the financial statements would be materially misstated absent correction of the errors, corrections should be made as follows:
- (a) If only the current period statements are presented, then the cumulative effect of correcting the error should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position.
 - (b) If comparative financial statements are presented, then the error should be corrected in the earliest affected period presented by correcting any individual amounts on the financial statements. If the earliest period presented is not the period in which the error occurred and the cumulative effect is attributable to prior periods, then the cumulative effect should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position for the earliest period presented.
 - (c) The nature of an error in previously issued financial statements and the effect of its correction on relevant balances should be disclosed. Financial statements of subsequent periods need not repeat the disclosures.
11. Prior period financial statements should only be restated for corrections of errors that would have caused any statements presented to be materially misstated.

¹ Accounting Principles Board Opinion No. 20, par. 13.

Changes in Accounting Principles

12. A change in accounting principle is a change from one generally accepted accounting principle to another one that can be justified as preferable. For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards.
13. Unless otherwise specified in the transition instructions section of a new FASAB standard, for all changes in accounting principles that would have resulted in a change to prior period financial statements:
- (a) The cumulative effect of the change on prior periods should be reported as a “change in accounting principle.” The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
 - (b) Prior period financial statements presented for comparative purposes should be presented as previously reported; and
 - (c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure.

The provisions of this statement need not be applied to immaterial items.

Appendix A: Basis For Conclusions

14. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
15. The Board received sixteen responses to the ED. All but one respondent were in support of the amendment. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondent's majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The respondent's comments are summarized below.

	Federal	Non-federal
Users, academics, others		2
Auditors	2	
Preparers and financial managers	12	

16. Seven respondents approved the amendment without further comment. Four approved the amendment but requested clarifying language, which has been incorporated into the standard. Two approved the amendment but would have preferred that the standard allow restatement for changes in accounting principles.
17. One respondent disapproved of the amendment because they believe the amendment will create additional confusion regarding the closing of prior period accounts and the subsequent issuance of financial statements.

Corrections of Errors

18. When SFFAS No. 7 was issued, the Board believed that having reporting entities restate prior period financial statements for prior period adjustments would create an unnecessary burden at a time when FASAB was still establishing a basic framework of standards. Changes in the federal accounting environment in the ensuing years have lessened these concerns. With the government's increasing ability to produce accurate and sophisticated financial statements, the Board is more concerned with encouraging reporting entities to

produce financial statements that are most useful to managers and other users.

19. Although comparative financial statements are not required by any of the accounting standards setting boards, it is generally held that “the presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise.”²
20. Reporting entities also recognize that presenting comparative statements greatly enhances the overall usefulness of financial statements. Despite the advantages of providing comparative statements, however, at least one governmental entity has been constrained from presenting its prior year statements because they contain a material error.
21. The Board has deliberated on the effects of the existing standard precluding restatement to correct errors on presentation of comparative financial statements. Although it believes that the considerations in effect at the time the existing standard was issued were valid, it has concluded that potentially losing or delaying the benefit of comparative statements now outweighs these considerations.
22. The Board concluded that the standard for Prior Period Adjustments should be amended to specifically require that prior period financial statements presented for comparative purposes be restated to correct material errors, and that restatement should be limited to only material errors.

Changes in Accounting Principles

23. Although the Board has chosen to retain the current methodology for reporting changes in accounting principle, it has revised the language to improve clarity and to require certain disclosures. The Board may consider exceptions to this decision, if warranted, for accounting standards issued in the future. It may also further examine issues raised by respondents regarding changes in accounting principles.

² Accounting Research Bulletin 43, Chapter 2A, paragraph 101.

Other Accounting
Changes

24. Although accounting estimates and changes in reporting entity are identified as accounting changes in other accounting literature, the Board did not address these issues because they require further study and were not addressed in paragraph 76 of SFFAS No. 7.

Board Approval

25. This statement was approved by unanimous vote of the Board.

Statement of Federal Financial Accounting Standards 22: Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources

Status

Issued	October 2001
Effective Date	For periods ending after September 30, 2000
Volume II References	Revenue (R40)
Interpretations and Technical Releases	None.
Affects	SFFAS 7
Affected by	No other statements.

Summary

Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources*, (SFFAS 7) requires a reconciliation of budgetary and financial accounting information. The reconciliation explains the relationship between budgetary resources obligated by the entity during the period and the net cost of operations as derived from the entity's proprietary accounting system.

This standard amends SFFAS 7 by deleting a requirement regarding an element of the reconciliation. SFFAS 7, paragraph 80, requires increases and decreases in receivables from the public related to exchange revenue to be reported as a nonbudgetary resource. This standard deletes this requirement and makes other necessary conforming changes.

The effect of this change is that the location of this reconciling item is no longer specified by the standard.

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Introduction

1. Statement of Federal Financial Accounting Standards (SFFAS 7) 7, *Accounting for Revenue and Other Financing Sources*, paragraphs 80-82, requires a reconciliation explaining the relationship between budgetary obligations incurred by the entity during the period and the net cost of operations. Paragraphs 95-102 in the concepts section of SFFAS 7 presents the statement of financing (SOF) as the vehicle for reporting the reconciliation.
2. Paragraph 80, SFFAS 7, requires, among other things, increases and decreases in receivables from the public related to exchange revenue to be reported as nonbudgetary resources. The Board is deleting, by means of this amendment, the sentence in paragraph 80 that requires such reporting, and making other conforming changes.
3. The effect of this change is that the location of this reconciling item in the statement of financing is no longer specified by the standard.

Materiality

4. The provisions of this accounting standard need not be applied to immaterial items.

Effective Date

5. This amendment is effective for periods beginning after September 30, 2000.

Accounting Standard

Changes for SFFAS 7

6. SFFAS 7 is amended as follows:

Delete the following sentence from paragraph 80:

Further, it should include decreases (increases) in receivables from the public related to exchange revenue when only the cash amount is included in budgetary resources.

Other conforming changes:

-
- Delete the following sentence from paragraph 97:

This amount would also include decreases (increases) in receivables related to revenue accrued from the public because, while the cash collected for exchange revenue is a budgetary resource, the accrual amount is not.

- Delete the following line item from Appendix 1- G, Example Financial Statements Formats, Statement of Financing

Exchange revenue not in the budget

Appendix A: Basis For Conclusions

7. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
8. As stated in previous sections, the Statement of Federal Financial Accounting Standards (SFFAS 7) 7, Accounting for Revenue and other Financing Sources, requires budgetary obligations incurred by the entity to be reconciled with the entity's net cost of operations.¹ The concept section of SFFAS 7 presents the statement of financing (SOF) as the vehicle for reporting the reconciliation.² A primary objective of the Board in creating the SOF is that readers of the financial statements are able to understand the difference between obligations, as reported in the budget, and the net cost of operations as reported in the statement of net cost.³
9. The Board issued an exposure draft in April 2001 proposing to delete the requirement in SFFAS 7, paragraph 80, that "decreases (increases) in receivables from the public related to exchange revenue" be reported as a nonbudgetary resource on the SOF. There are instances where reporting the change in "receivables from the public related to exchange revenue" as a resource, as is currently required by SFFAS 7, may be inappropriate. This amended standard would permit flexibility.
10. The effect of this change is that the location of this reconciling item in the statement of financing is no longer specified by the standard.

Respondents' Comments

11. The respondents' comments are summarized below. The Board does not rely on the number of respondents in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board

¹ SFFAS 7, paragraphs 80-82.

² SFFAS 7, paragraphs 95-102. See the Implementation Guide to Statement of Federal Financial Accounting Standards No. 7, Accounting for Revenue and Other Financing Sources, pars. 72-95 for a discussion and illustrations of the statement of financing.

³ Implementation Guide for SFFAS 7, par. 72.

considers the arguments in each response and weighs the merits of the points raised.

	Federal	Non- federal
Users, academics,others	1	3
Auditors	2	1
Preparers and financial managers	7	

12. Nine respondents either said they agreed with or had no objection to the amendment. One respondent agreed with the change but disagreed with the decision to issue the standard allowing flexibility. Four respondents reviewed the exposure draft but chose not to comment or offered a comment beyond the scope of the issue addressed by the exposure draft. Respondents made the following individual comments:
- a. placement of the line item should be made mandatory now, rather than allowing flexibility
 - b. optional presentations reduce understandability
 - c. adding a brief discussion of the alternative presentations to the basis for conclusions would make the amendment more understandable
 - d. a reference to the discussion of the SOF in the FASAB's Implementation Guide to SFFAS 7 (April 1996) would be helpful
 - e. the SOF is useful; encourage further improvements
 - f. the title of the SOF should include the word "reconciliation"
 - g. consider making the SOF supplementary information
 - h. users would use either budgetary or accrual information, not both, so a reconciliation of obligations and net costs as in the SOF is not useful.

Conclusion

13. In light of the comments received from respondents, the Board believes there is support for proceeding with this amendment. The Board considered the comments from several respondents that the

basis for conclusions contain a brief discussion of alternative SOF presentations, but continues to believe that such a discussion must be postponed until a fuller review of the statement of financing is undertaken. The SOF is complex, and the narrative and illustrations necessary to present a full discussion of and rationale for the alternatives should be undertaken during a comprehensive updating of the implementation guidance.

Vote for Approval

14. All members of the Board approved this statement.

**Appendix B:
Paragraphs 80 and
97 of SFFAS 7****The current paragraphs are as follows:**

80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different, causing differences in the basis of accounting. To better understand these differences, a reconciliation should explain the relationship between budgetary resources obligated by the entity during the period and the net cost of operations. It should reference the reported “obligations incurred” and related adjustments as defined by OMB Circular A- 34. It also should include other financing sources not included in “obligations incurred” such as imputed financing, transfers of assets, and donations of assets not included in budget receipts. Further, it should include decreases (increases) in receivables from the public related to exchange revenue when only the cash amount is included in budgetary resources. The total of these items comprises obligations and nonbudgetary resources.
97. **Nonbudgetary resources** represent the net amount of resources received by the entity that are not included in budgetary resources. These items could include donations of assets, transfers of assets from (to) other federal entities, and financing imputed for cost subsidies. This amount would also include decreases (increases) in receivables related to revenue accrued from the public because, while the cash collected for exchange revenue is a budgetary resource, the accrual amount is not.

Statement of Federal Financial Accounting Standards 23: Eliminating the Category National Defense Property, Plant, and Equipment

Rescinding SFFAS No. 11, *Amendments to Property, Plant, and Equipment -- Definitional Changes*
Amending SFFAS No. 8, *Supplementary Stewardship Reporting*
Amending SFFAS No. 6, *Accounting for Property, Plant, and Equipment*

Status

Issued	May 8, 2003
Effective Date	This Statement is effective for accounting periods beginning after September 30, 2002, with earlier implementation encouraged.
Volume II References	Consolidated Financial Report of the U. S. Government (C60), General Property, Plant, and Equipment (G20), Land (L10)
Interpretations and Technical Releases	None
Affects	<ul style="list-style-type: none">• SFFAS 6, <i>Accounting for Property, Plant and Equipment</i> (for additional PP&E discussion and cleanup cost standards)• SFFAS 8, <i>Supplemental Stewardship Reporting</i> (Rescinds the prefatory box preceding paragraph 52 of SFFAS 8 and paragraphs 52 through 70 of SFFAS 8.)
Affected by	None.

Summary

Prior to this amendment, the acquisition costs for items classified as national defense (ND) property, plant, and equipment (PP&E) were expensed in the period incurred. In addition, valuation (using either an historical or latest acquisition cost valuation method), condition, and deferred maintenance information for these items was to be presented off-balance sheet.

The amendments in this Statement make the following changes. The term “ND PP&E” is rescinded. All items previously considered ND PP&E are classified as general PP&E. Accordingly, the cost of these items should be capitalized and, with the exception of the cost of land and land improvements that produce permanent benefits, depreciated. This Statement also notes that all entities are permitted to use the composite or group depreciation methodology to calculate depreciation.

The amendments in this Statement take effect for accounting periods beginning after September 30, 2002.

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Introduction

1. The purpose of this Statement is to amend certain standards with regard to national defense (ND) property, plant, and equipment (PP&E). The standards being amended are contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 11, *Amendments to Accounting for Property, Plant, and Equipment -- Definitional Changes* (December 1998); SFFAS No. 8, *Supplementary Stewardship Reporting* (June 1996); and, SFFAS No. 6, *Accounting for Property, Plant, and Equipment* (November 1995).

Background

2. Pursuant to SFFAS No. 6, costs to acquire, replace or improve ND PP&E¹ were recognized² as an expense in the period incurred. Consistent with the treatment of the acquisition cost of ND PP&E, SFFAS No. 6 also required that the total estimated cleanup cost be recognized as an expense and a liability established in the period the ND PP&E item is placed in service. A further requirement of SFFAS No. 6, as amended by SFFAS No. 14, is that deferred maintenance amounts be presented as Required Supplementary Information (RSI).³
3. The Supplementary Stewardship Reporting standards in SFFAS No. 8 required presenting a valuation of ND PP&E. The following values were to be presented:
 - a. a beginning value balance for ND PP&E;
 - b. the dollar values for ND PP&E acquired during the reporting period;

¹ Originally, ND PP&E was defined in SFFAS No. 6 as Federal mission PP&E. Subsequent to the issuance of SFFAS No. 6, many agencies suggested that the Federal mission PP&E category would be appropriate for agency PP&E not considered by the Board in developing the category. To prevent confusion, inconsistency, and unintended application, the Board replaced the definition of Federal mission PP&E with the definition of ND PP&E currently contained in SFFAS No. 11 to clarify that only DoD and the Maritime Administration's National Defense Reserve Fleet PP&E would be categorized as ND PP&E.

² "Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.

³ This amendment does not change any requirements for deferred maintenance.

-
- c. the dollar values for ND PP&E withdrawn during the reporting period;
 - d. the increase or decrease in values resulting from revaluation of assets using the latest acquisition cost (LAC); and,
 - e. the end-of-year values by major type or category of ND PP&E.

The values were to have been determined using either an historical or LAC valuation method.

- 4. In addition to the values, condition information was required. The valuation and condition information was presented as Required Supplementary Stewardship Information (RSSI) – that is, outside of the principal financial statements.
- 5. Current Board members acknowledge that the stewardship approach was adopted, not as a convenience or temporizing expedient, but as a technically desirable approach. However, an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of the Government Performance and Results (GPRA) Act, combined with the Board's and Department of Defense's (DoD) extensive study and greater understanding about National Defense PP&E, provide a clear indication that the operating performance objective is relevant for ND PP&E. Accordingly, the Board rescinds SFFAS No. 11 and amends SFFAS Nos. 6 and 8.

Summary of Amendments

- 6. The amendments in this Statement:
 - a. Rescind the term "ND PP&E" and its definition ;
 - b. Classify all assets previously considered to be ND PP&E as general PP&E and, the provisions for general PP&E and associated cleanup costs for general PP&E contained in SFFAS No. 6, as amended, are to be applied; and,
 - c. Continue to permit the composite or group depreciation methodology to depreciate general PP&E.

Effective Date	7. This Statement is effective for accounting periods beginning after September 30, 2002, with earlier implementation encouraged.
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Accounting Standards

Amendments to Existing Standards	<p>8. The amendments to accounting standards for assets previously identified as national defense (ND) property, plant, and equipment (PP&E) and implementation guidance are presented in paragraphs 9 through 18 that follow.</p> <p>9. The amendments affect existing standards, for periods beginning after September 30, 2002 or upon early implementation of this Statement, in the following manner:</p> <ul style="list-style-type: none">a. SFFAS No. 11 is rescinded in its entirety;b. The prefatory box preceding paragraph 52 of SFFAS No. 8 is rescinded;c. Paragraphs 52 through 70 of SFFAS No. 8 are rescinded;d. Paragraph 21 of SFFAS No. 6 is amended by rescinding the category name "Federal mission property, plant, and equipment;"e. Paragraphs 46 through 56 of SFFAS No. 6 and the accompanying heading "Federal mission property, plant, and equipment;" which precedes these paragraphs, are rescinded;f. SFFAS No. 6 is amended by adding the following sentence to paragraph 35 as a separate bulleted line item:
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-
- A composite or group depreciation methodology⁴, whereby the costs of PP&E are allocated using the same allocation rate, is permissible.
-

Implementation Guidance

Initial Capitalization

10. The initial capitalization amount for assets previously considered ND PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6, as amended, and should be the initial historical cost for the items, including any major improvements or modifications.
11. This standard recognizes that determining initial historical cost may not be practical for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate.
12. If obtaining initial historical cost is not practical, estimated historical cost may be used. Other information such as but not limited to budget, appropriation, or engineering documents and other reports reflecting amounts expended may be used as the basis for estimating historical cost.
13. Alternatively, estimates of historical cost may be derived by estimating the current replacement costs of similar items and deflating those costs, through the use of price-level indexes, to the acquisition year or estimated acquisition year if the actual year is unknown. Other reasonable approaches for estimating historical cost may also be utilized. For example, latest acquisition cost may be substituted for current replacement cost in some situations.

⁴The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

Adjustment to Cumulative
Results of Operations

14. A contra asset account—accumulated depreciation—for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS No. 6, as amended.
15. For military equipment that is in service upon implementation of this standard, cleanup cost liabilities should be adjusted, as needed.⁵
16. The cumulative effect of adopting this accounting standard should be reported as a “change in accounting principle.” The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position, for the period the change is made.
17. Prior year financial statements presented for comparative purposes should be presented as previously reported.
18. The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosures.⁶

The provisions of this statement need not be applied to immaterial items.

⁵ Under the provisions of SFFAS No. 6, paragraph 97, a portion of the estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation and a liability accumulated over time as expense is recognized. This adjustment may be needed because the DoD may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS No. 6, as amended.

⁶ SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, paragraphs 12 and 13.

Appendix A: Basis For Conclusions

19. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Introduction

20. The Board issued an exposure draft (ED), *Eliminating the Category National Defense Property, Plant, and Equipment*, to rescind SFFAS No. 11, *Amendments to Property, Plant, and Equipment -- Definitional Changes* and to amend SFFAS No. 8, *Supplementary Stewardship Reporting* and SFFAS No. 6, *Accounting for Property, Plant, and Equipment* in March of 2002. Twenty comment letters were received during a comment period that ended May 20, 2002. The majority of respondents supported the proposals presented in the ED. Concerns raised by the respondents dealt mostly with providing additional guidance for the valuation and consumption of items. Two other concerns dealt with the impact of the Statement on contractor costs and the effective date of the Statement. Background information pertaining to the development of this Statement and discussions on the concerns raised by respondents are addressed in the following paragraphs.

Background

21. The Federal Accounting Standards Advisory Board (FASAB) has studied accounting and reporting approaches for Property, Plant, and Equipment (PP&E) for a number of years. FASAB's initial standards for PP&E began with the development of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and followed with SFFAS No. 8, *Supplementary Stewardship Reporting*.
22. SFFAS No. 6 requires that general PP&E be recognized as assets in the basic financial statements and, except for land and land improvements that produce permanent benefits, be charged to expense through depreciation over their useful life. SFFAS No. 6, paragraph 122, states that "allocation of the cost of general PP&E, excluding land, among accounting periods was essential to assessing operating performance." The Board's federal financial reporting objectives concept statement, Statement of Federal Financial Accounting Concepts (SFFAC) No.1, focuses on relating costs to accomplishments in reporting an entity's operating performance. To meet the operating performance objective

for general PP&E, the Board sought to provide accounting standards that would result in:

- a. relevant and reliable cost information for decision-making by internal users;
 - b. comprehensive, comparable cost information for decision-making and program evaluation by the public; and,
 - c. information to help assess the efficiency and effectiveness of asset management.
23. The Board, however, found that for some PP&E, the depreciation effect of the asset on operating performance was not the predominant reporting objective. Instead, stewardship was important. Therefore, three categories of assets (i.e., national defense PP&E (ND PP&E),⁷ heritage assets, and stewardship land) are referred to collectively as stewardship PP&E.
24. The purpose of SFFAS No. 8 was to establish standards for reporting on the Federal Government's stewardship over certain resources entrusted to it, and certain responsibilities assumed by it. Among these standards are standards for reporting on stewardship PP&E. "Stewardship PP&E" consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differs from general PP&E in that their values may be indeterminable or may have little meaning (e.g., museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (e.g., ND PP&E) to accounting periods that benefit from the ownership of such assets is not meaningful. Specifically, for ND PP&E the majority of the Board did not believe applying depreciation accounting for these assets would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believed that these assets were developed, used, and retired in a

⁷ Prior to the issuance of SFFAS No. 11, *Amendments to Accounting for Property, Plant, and Equipment – Definitional Changes*, (amending SFFAS Nos. 6 and 8) the Board referred to ND PP&E as Federal Mission PP&E. The reasons leading to that change are not relevant to this ED but may be understood by reading SFFAS No. 11. This document uses the amended title and definition in referring to the existing provisions.

manner that did not lend itself to a "systematic and rational" assignment of costs to accounting periods (i.e., depreciation accounting) and, ultimately, to outputs.

25. Accordingly, one result of SFFAS Nos. 6 and 8 was to remove the PP&E components of ND PP&E from the balance sheet. To accomplish this, SFFAS No. 6 (as amended) required that the cost to acquire ND PP&E components be expensed when incurred. SFFAS No. 8 (as amended), required presenting ND PP&E as stewardship information and included the following information by major type or category of ND PP&E:
- a. a beginning value balance, using either a historical or latest acquisition cost (LAC) valuation method;
 - b. the dollar value acquired during the reporting period;
 - c. the dollar value withdrawn during the reporting period;
 - d. the increase or decrease in value resulting from revaluation of assets using the LAC; and,
 - e. the end-of-year value.
26. In addition to presenting values, SFFAS No. 8 required that condition information be presented. The presentation of value and condition information was done off-balance sheet as Required Supplementary Stewardship Information (RSSI). In addition to value and condition, SFFAS No. 6, as amended, required deferred maintenance information to be presented as Required Supplemental Information (RSI) for ND PP&E.
- February 1998 ED
27. In early 1998, the FASAB issued an exposure draft (ED) to amend SFFAS Nos. 6 and 8. The exposure draft was initiated (1) to refine the definition of ND PP&E, and (2) in recognition of the need to provide a transition plan due to the DoD's inability to comply with the provisions of SFFAS No. 8. During the process, the Board reconsidered whether SFFAS No. 8 was an appropriate end goal. Ultimately, the 1998 exposure draft included, among other suggestions, proposals to replace the requirement to present cumulative cost information in the supplementary stewardship report with a requirement to present ND PP&E annual acquisition costs for each of the previous five years (i.e.,

annual trend information rather than cumulative costs), quantities, and condition information.

28. Besides considering the written comments in response to this 1998 ED, the Board held a public hearing on these proposals to explore further the concerns expressed by some respondents. Because of the divergent views of both respondents and Board members, the Board did not reach a final conclusion on revisions to the reporting requirements for ND PP&E in SFFAS No. 8. The Board's continued deliberations on the proposed standards highlighted the differences of opinion on this subject among the Board members. Since neither the standards in SFFAS No.8 nor the proposed amendments were acceptable to a majority of the Board members, the Board decided that the accounting for and reporting on ND PP&E requirements should be revisited. DoD voluntarily undertook a study to address (1) users information needs relative to ND PP&E, (2) the current systems capabilities within DoD, and (3) an assessment of alternative means to meet the reporting objectives set by the Board.
29. The Board acknowledges that the SFFAS No. 8 stewardship approach was adopted, not as a convenience or temporizing expedient, but as a technically desirable approach. However, an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of the Government Performance and Results (GPRA) Act, combined with the Board's and DoD's extensive study and greater understanding about National Defense PP&E, provides a clear indication that the operating performance objective is relevant for ND PP&E.

September 2001 ED

30. In September 2001, the FASAB issued an ED that proposed incremental movement from the stewardship reporting of SFFAS No.8 towards information focused on operating performance. The amendments proposed in that ED would have made the following changes. The definition of ND PP&E would have been amended. ND PP&E would have consisted of 2 separate categories of items within the amended definition: (a) Major End Items and (b) Mission Support Items. Major End Items would have been subject to a presentation of the number of units and condition assessment information by asset type or category. In addition, Major End Items would have been capitalized but not depreciated, while Mission Support Items would have been capitalized and depreciated. Also, data for the ten largest current acquisition programs would have been disclosed.

31. The Board issued the 2001 ED because it believed that the proposals in that ED were the best that could be achieved given the acknowledged shortcomings of DoD accounting and other management information systems, as well as DoD's firm belief that certain information would not be useful for management purposes. The 2001 ED would have achieved one of the current Board's objectives, which was to establish monetary accountability over military assets. However, because the 2001 ED did not require depreciation of some major assets, the September 2001 FASAB ED on NDPP&E fell short of comprehensive PP&E accounting. In addition, it would not have fully achieved the objective of SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, to account for the full cost of programs with a focus on relating costs to accomplishments in reporting an entity's operating performance.

March 2002 ED

32. While there were divergent views on the proposals in the September 2001 ED, many respondents believed ND PP&E should be capitalized and depreciated as is general PP&E. Many Board members had wanted to make this change for some time. This caused the Board to reconsider the proposals presented in the September 2001 ED. The outcome from the deliberations was a consensus of the Board to make the proposal in the March 2002 ED to classify, capitalize, and depreciate ND PP&E as general PP&E. The Board believed its proposal would put discipline into the asset management process. Many members of the Board believe depreciation, impairment, deferred maintenance, and condition are interrelated judgments that should result jointly from periodic estimation of the remaining useful service potential of assets. The Board believes periodic analysis of the sources of asset diminution is as important, perhaps more so, for national defense assets than for other assets.

33. The Board also notes that a second purpose of depreciation accounting is to provide information for measuring the full cost of producing outputs (e.g., deterrence, readiness, training). Full cost, including the depreciation of ND PP&E, would be available for use in assessing the operating performance of responsibility segments for producing outputs and to meet the goals of SFFAC No. 1 and SFFAS No. 4. In addition, the Board believes that classifying all DoD PP&E as general PP&E would improve the public's understanding of federal accounting, add consistency to the application of standards throughout the Federal government, reduce the DoD's cost of development and operation of accounting systems, and preclude the

standard setting costs that would be necessary to resolve on-off balance sheet questions. Accordingly, the Board proposed to rescind SFFAS No.11 and amend SFFAS Nos. 6 and 8.

34. Although the September 2001 ED on ND PP&E proposed three special disclosures for ND PP&E, the Board decided not to include them in the March 2002 ED. The three special disclosures proposed in the September 2001 ED were:
- a. unit information by type or category of Major End Item⁸;
 - b. condition assessment information for Major End Items; and,
 - c. actual and planned acquisition program costs and unit information for the ten largest current national defense PP&E⁹ acquisition programs.
35. These proposed information requirements were developed and proposed after years of deliberation and with varying recognition and measurement requirements for the principal financial statements. The Board decided not to propose these three special information requirements as part of the March 2002 ED after reviewing responses to the September 2001 ED. The Board concluded that these areas may deserve further study or development for the following reasons:
- a. Unit information as originally proposed was tied to the Major End Item definition. Respondents questioned the definition's effectiveness.

⁸ The *Accounting for National Defense PP&E and Associated Cleanup Costs* ED, dated September 2001, defined Major End Items to be: 1) items that launch, release, carry, or fire a particular piece of ordnance, and 2) items that carry weapons systems-related property, equipment, materials, or personnel. Major End Items (a) have an indeterminate or unpredictable useful life due to the manner in which they are used, improved, modified, or maintained and (b) are subject to premature destruction or obsolescence (e.g., aircraft, ships, combat vehicles, etc.) Also, included in this category are vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

⁹ SFFAS No. 11 defined ND PP&E as being "PP&E [that] are (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (2) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet."

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- b. Unit and condition information has been determined to be “sensitive” information¹⁰.
 - c. Many respondents suggested that further research in the area of condition and deferred maintenance presentation is needed to develop consistent and comparable measurement and reporting criteria. However, respondents found condition information to be a useful supplement to deferred maintenance.
 - d. One respondent suggested that the proposed reporting on the ten largest acquisition programs would confuse users since the cost of assets recognized on the balance sheet would be different from budget cost measurements.
36. Given the resources that have been devoted to resolving the fundamental recognition and measurement guidance for ND PP&E and the substantial efforts underway at DoD to modernize its systems, the Board does not believe it would be useful to withhold this Statement while it deliberates on the merits of any further PP&E information.
37. In the meantime, the Board does not believe the absence of the previously proposed special information requirements would outweigh the benefits to be gained through this Statement. With regard to the stewardship objective and the need for unit information, the Board notes that the stewardship objective is being met for general PP&E without this special disclosure. Through the course of the audit, existence of PP&E and the completeness of PP&E records are verified. This satisfies the basic stewardship function that the double entry system offers.
38. With regard to condition information, the Board notes that deferred maintenance information is currently required. Further, the assessment of useful life needed to assure depreciation is reasonable would result in greater discipline in information associated with the condition of PP&E.

¹⁰ Any information, the loss, misuse, or unauthorized access to which would or could adversely affect the organizational and/or national interest but which does not meet classification criteria specified in DoD 5200.1-R (reference (c)). Source: DoD 5200.1-M; Acquisition Systems Protection Program; 16 March 1994.

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39. The Board expects to revisit these areas as it considers a project on integrating depreciation, impairment, and deferred maintenance reporting and other fixed asset accounting issues at a future date. The effort would be a government-wide undertaking.
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Concerns with March 2002 ED

- Valuation and Consumption
40. Various respondents suggested that additional guidance be included in this Statement for the valuation and consumption or use of items previously classified as national defense (ND) property, plant, and equipment. Examples of the types of additional guidance suggested include the following:
- a. The cost elements of research, testing, development, and evaluation (RTD&E) should be described and specific guidance provided on capitalization.
 - b. Definitions for terms such as modifications, modernizations, and improvements are needed.
 - c. More discussion of the desired accounting for the losses of items considered part of a group asset account of ND PP&E during testing, development, or evaluation phases is needed.
 - d. More guidance for determining the capitalized costs to be removed from a group asset account when a unit is destroyed, becomes obsolete, or is otherwise disposed of is needed.
 - e. The role of subordinate systems needs to be addressed, along with a description of how the costs of the subordinate systems would be relieved of costs assigned to the higher level system.
 - f. A discussion of appropriate treatment for the costs of a discontinued subordinate system is needed.
 - g. The use of depreciation to reflect the full cost of operating ND PP&E items has to be tailored to the unique attributes and uses of ND PP&E.

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- h. The useful lives of certain classes of ND PP&E should be defined and measured in units such as operating hours.
 - i. Additional guidance and criteria is needed regarding the use of composite and group depreciation methodologies.
 - j. Specific reference to abnormal disposition issues should be added to the standard.

- 41. In response to these issues, the Board members reiterated that the Board is responsible for promulgating accounting standards and that it is the responsibility of individual entities to set policy and provide operating guidance on how to implement the standards. The Board believes these issues can and should be addressed by individual entities in the context of existing basic principles and practices. Composite and group depreciation methodologies are already considered acceptable methods under generally accepted accounting principles. The existing principles and practices are used by many different industries, including the airline, electrical cooperative, railroad, real estate, and cruise line industries.
- 42. The Board also expects that many of these concerns raised by respondents will be addressed by DoD as the standards are implemented. One example may be on the cost elements of research, testing, development, and evaluation (RTD&E) to be capitalized. Determining whether to include a particular cost in the capitalized cost of PP&E should be guided by general guidance in SFFAS Nos. 4 and 6 regarding the types of costs to be capitalized. In the event, however, that DoD is unable to resolve issues, the Board and its staff will be available to consider implementation guidance.

Contractor Costs

- 43. Two respondents raised concerns regarding application of existing general PP&E accounting standards to PP&E formerly classified as National Defense PP&E but held by contractors. Since the current PP&E definition explicitly includes PP&E in the hands of others (paragraph 18), SFFAS Nos. 6 and 8 (as amended) created reporting requirements for general PP&E and National Defense PP&E. Both existing standards require cost information.
- 44. One respondent, apparently unaware of the aforementioned provisions of SFFAS Nos. 6 and 8, encouraged the Board to develop standards that address this property. The respondent asserted,

“accounting control over this property is deplorable.” Information provided by the respondent shows that as early as 1981 issues were raised regarding the need to improve accountability for assets including PP&E provided by the Government at no cost to the contractor for use in contract performance.

45. Another respondent, an industry group including major defense contractors, suggests that the elimination of the National Defense PP&E category “will impose costly accounting change requirements on government contractors that will increase the costs of goods and services acquired by the government.” The respondent raised concerns about (1) application of standards to immaterial items, (2) provisions for accounting for software modifications, (3) requirements for work-in-process reporting, and (4) designation of specific cost elements for capitalization (SFFAS No. 6, para 26). Some aspects of these and other issues raised by the respondent appear to the Board to be based on misinterpretations of the existing standards. Therefore, the Board does not believe there are insurmountable issues raised.
46. Rather, the Board believes that significant efforts are needed to clarify the standards for contractors and to determine specific reasonable policies for providing information. It is clear that, despite the existence of standards for contractor held assets since late 1995, little progress has been made in resolving the issue. The Board does not believe that deferral of standards related to vast amounts of PP&E will facilitate resolution of the contractual and administrative details needed to reasonably comply with generally accepted accounting principles.
47. One respondent commented that the effective date, for periods beginning after September 30, 2002, is unrealistic. The Board acknowledges that full implementation of the standards will require time and commitment. The Board understands that DoD is currently developing systems needed to fully implement any PP&E standards, comprehensive training needs to be provided, policies and procedures need to be revised and contractors may need to modify how they do things. However, the Board believes DoD financial statements will be incomplete without consistent and comparable accounting for PP&E. In addition, a practical issue arises. DoD has not yet identified property as National Defense PP&E. Therefore, it would be problematic to determine which components of general PP&E were

Effective Date

not yet subject to the provisions of SFFAS No. 6, which became effective for fiscal year 1998.

Board Approval

48. The Board approved this recommendation by a vote of 6 members approving its issuance and 1 member opposing its issuance. Although the Board is comprised of 9 members, only 7 members cast a vote. This is because the term of two Board members had expired and the appointment of successors had not been finalized. The dissent of the Board member who opposed the issuance of this Statement is presented in paragraphs 49 through 51.
49. Mr. Calder dissents from this standard because (1) more guidance on asset capitalization and use of composite or group depreciation methods is needed and (2) additional disclosures are important to meeting reporting objectives for National Defense PP&E.
50. Mr. Calder believes that deliberations uncovered serious issues regarding identification of costs to be capitalized and application of composite or group depreciation methods to complex weapons systems. Comments showed there is diversity of understanding among financial statement users, preparers and auditors on these issues. He believes additional guidance should have been provided regarding the components of asset cost that should be capitalized; especially the accounting treatment for research, development, testing and evaluation. He does not believe the guidance in this regard in Statement Nos. 4 and 6 is adequate to resolve complex and diverse situations unique to defense assets. He also believes the new statement lacks guidance regarding the appropriate use of composite or group depreciation and could result in unacceptable diversity in its application.
51. In addition, Mr. Calder believes that the statement should have required disclosure of unit information for significant categories of assets and budget/actual data on major acquisitions programs in progress. Unit information has been deliberated at length by the Board over a number of years because some members and commentators believed the unit information is critical to an understanding of whether DoD has assets sufficient to carry out its mission. Information on budget/actual data on major acquisitions programs is considered by many to be vital to assessing performance in acquiring assets through complex and lengthy acquisition programs. In addition, tracking

progress against plans would aid in determining the financial status of the programs. These two additional disclosures would enhance users' understanding of the nation's financial condition and future security.

Statement of Federal Financial Accounting Standards 24: Selected Standards for the Consolidated Financial Report of the United States Government

Status

Issued	January 2003
Effective Date	For periods ending after September 30, 2001
Volume II References	Consolidated Financial Report of the US Government (C60)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

Summary

Most Statements of Federal Financial Accounting Standards (SFFAS) do not state whether they apply to the Government as a whole or components thereof, or both. This standard clarifies that all parts of all SFFAS apply to all Federal entities (including the consolidated entity) unless a standard specifically provides otherwise.

In addition, certain requirements of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, are not relevant for the Consolidated Financial Report of the United States Government (CFR). SFFAS 7 requires information on budgetary resources and a reconciliation of obligations and other resources used with the net cost of operations. These requirements, while relevant for agencies executing the budget, are not required for the CFR.

This standard requires that new statements be presented in the CFR, but not agency or departmental financial statements, regarding net operating revenue (or cost), budget surplus (or deficit), and cash. The new statements are principal CFR financial statements, and they are to be presented on a comparative basis.

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Introduction

1. Statements of Federal Financial Accounting Standards (SFFAS) usually do not state explicitly whether they apply to the Government as a whole, its component entities (e.g., departments, agencies, etc.), or both. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, uses the term “entity” generically to refer, depending on the context, to the U.S. Government as a whole, organizational component units of the Government, e.g., an agency, or to other kinds of potential reporting units such as programs.
2. Some have assumed that the standards apply to both component entities and the Government as a whole, unless otherwise stated. SFFAS 1, *Accounting for Selected Assets and Liabilities of the Federal Government*, states that it applies to the Government and its departments and agencies, as does SFFAS 8, *Supplementary Stewardship Reporting*. SFFAC 2, *Entity and Display*, states that Federal entities aggregate into the Government entity, which encompasses all the resources and responsibilities existing within the component entities.
3. This standard clarifies that all existing and future standards apply to all federal entities unless a standard specifically provides otherwise.
4. This standard also exempts the CFR from certain provisions of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requiring information about budgetary resources and a reconciliation of budgetary obligations with the cost of operations from the proprietary accounting system. Such information is relevant and meaningful for entities financed with budgetary resources but not for the Government as a whole.
5. In addition, this standard requires new information for the CFR (but not component entity financial statements) that reconciles the annual proprietary net cost with the unified budget surplus (or deficit), and explains the changes in the Government’s cash balance. The information is to be presented in new CFR principal financial statements that are to be presented on a comparative basis.

Materiality	6. The provisions of this accounting standard need not be applied to immaterial items.
Effective Date	7. This amendment is effective for periods beginning after September 30, 2001.

Accounting Standard

Standards for the Consolidated Financial Report of the U.S. Government	8. Statements of Federal Financial Accounting Standards (SFFAS) apply to all federal entities, that is, to the Government as a whole and to component entities (terms defined in the glossary appear initially in boldface), unless provision is made for different accounting treatment in a current or subsequent SFFAS.
Budgetary Information Not Required for the Government as a Whole	9. SFFAS 7, paragraphs 77-82, requires certain information about budgetary resources and about the relationship between budget obligations and proprietary net cost of operations . Such information is reported in the Statement of Budgetary Resources and Statement of Financing, respectively. ¹ This information is not required in the consolidated financial report of the Government as a whole, and accordingly such statements are not required.
Reconciliation Information	10. The financial report of the Government as a whole should provide a financial statement reconciling net operating revenue (or cost) and the annual unified budget surplus (or deficit) . The financial statement should highlight: <ul style="list-style-type: none"> The components of net operating revenue (or cost) that are not part of the unified budget surplus (or deficit), including the

¹ See Appendices D and E for illustrations of the statement of budgetary resources and statement of financing from the Office of Management and Budget's Bulletin 01-09, *Form and Content*.

accrued and amortized expenses not included in **budget outlays** and the accrued or other revenue not included in **budget receipts**; and

- The components of the unified budget surplus (or deficit) that are not part of net operating revenue (or cost), including budget receipts and outlays that are not included in net operating revenue (or cost).

11. Appendix B provides an illustration of how the reconciliation data could be displayed. The illustration is not intended to be prescriptive.

Information about the Unified Budget Surplus or Deficit and Cash

12. The Government as a whole should provide a financial statement explaining how the annual unified budget surplus or deficit relates to the change in the Government's cash. The financial statement should highlight:

- The components of the unified budget surplus or deficit that are not part of the annual change in cash, including non-cash budget outlays; and
- Items affecting the Government's cash balance that are not included in the budget outlays or receipts. The statement should prominently display the cash inflow and outflow related to the changes in debt held by the public and interest accrued and interest paid on debt held by the public.

13. Appendix C provides an illustration of how this information could be displayed. The illustrations are not intended to be prescriptive.

Principal Financial Statements Presented on a Comparative Basis

14. The financial statements required in paragraphs 10-13 immediately above are **principal financial statements**. These statements and all other principal financial statements in the consolidated financial report of the Government as a whole should be presented on a comparative basis. The current fiscal year amounts should be presented in a column adjacent to the amounts for the previous fiscal year.

Appendix A: Basis for Conclusions

15. This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
16. FASAB published the exposure draft Selected Standards for the Consolidated Financial Report of the United States Government, in March 2002. The exposure draft included questions about each of the three areas of interest: (1) whether standards should apply to the Government as a whole as well as to component entities; (2) whether the CFR should be exempt from the requirement for a Statement of Budgetary Resources and a Statement of Financing; and (3) whether new statements should be required for the Government as a whole.
17. The Board received 16 responses as follows:

Category	Federal (Civilian)	Federal (Military)	Non-Federal
Users, academics, and others ²			5
Auditors	1	1	
Preparers and financial managers	8	1	

Standards Apply to the Government as a Whole as Well as to Component Entities

18. In Statement of Federal Financial Accounting Concepts (SFFAC) 1 *Objectives of Federal Financial Reporting*, the Board uses the term “entity” generically to refer, depending on the context, to the Government as a whole, organizational component units of the Government, e.g., an agency, or to other kinds of potential reporting units such as programs.³ SFFAC 2, *Entity and Display*, states that Federal entities aggregate into the Federal Government entity, which encompasses all the resources and responsibilities existing within the component entities.⁴

² This category includes professional organizations, academics, and private citizens.

³ SFFAC 1, fn. 2-3, and par. 212.

⁴ SFFAC 2, par. 38.

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19. Although Statement of Federal Financial Accounting Standards (SFFAS) 1, *Accounting for Selected Assets and Liabilities of the Federal Government*, states that it is applicable to both the Government as a whole and component entities⁵, other standards have not explicitly addressed the subject unless different treatment was specified. SFFAS 6, *Accounting for Property, Plant, and Equipment*, refers the reader to SFFAC 2, *Entity and Display*, for guidance on the general applicability of federal accounting standards. SFFAS 8, *Supplementary Stewardship Reporting*,⁶ explicitly states that it applies to the Government and its departments and agencies; and sets an effective date for its applicability to component entities but not for the Consolidated Financial Report of the U.S. Government (CFR) because more time is needed to delineate how the stewardship information would be aggregated. SFFAS 8 also requires a “current services assessment” for the CFR but not for individual reports of its component units. Likewise in SFFAS 17, *Social Insurance*, applicability is addressed because certain requirements for component entities are not applicable to, and summarization of certain data is allowed for, the CFR.
20. This standard clarifies that SFFAS apply to all Federal entities unless a current or subsequent standard specifically provides otherwise. All of the respondents who addressed the issue agreed that the FASAB standards should apply to the CFR. Several respondents requested more guidance regarding whether the proposed standard affected the FASAB policy whereby “financial statements [prepared] in accordance with accounting standards published by [the Financial Accounting Standards Board (FASB)] also may be regarded as in accordance with GAAP for those entities that have in the past issued such financial statements.”⁷ The Board did not intend to change and is not changing this policy at this time.

⁵ SFFAS 1, par. 14.

⁶ SFFAS 8, par. 38-39.

⁷ *FASAB News*, Jan.-March 2000, p. 2.

Consolidated Financial Report Exemption from Requirements to Report Certain Budgetary Information

21. All but one of the respondents who addressed the issue agreed that the CFR should be exempt from certain provisions of SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Budgetary and Financial Accounting*, requiring a Statement of Budgetary Resources (SBR) and the Statement of Financing (SOF). One respondent disagreed, saying that the same information, based on one single set of standards, required for components should be required for the CFR, and vice versa. That respondent believes that the CFR should present the SBR and SOF, because such combined budgetary information is relevant and useful to the user of the CFR. Likewise, the component entities should be required to prepare the new statements, the necessary changes being made, as well as the SBR and SOF.
22. SFFAS 7 requires entities “whose financing comes wholly or partially from the budget” to provide information on budgetary resources and the status of resources, which is presented in the SBR.⁸ It also calls for a reconciliation of budgetary resources obligated by the entity with the net cost of operations, which is presented in the SOF.⁹
23. The Board continues to believe that such information is less relevant or meaningful at the level of the CFR. Resources differ between the Government as a whole and individual component entities. The exchange and non-exchange revenue and borrowing from the public are the main sources of financing for the Government as a whole.¹⁰ For component reporting entities, however, the sources of financing

⁸ SFFAS 7 (pars. 77-79) requires information, which is presented in the SBR, that includes (1) total budgetary resources available, (2) the status of the budgetary resources, including obligations incurred, the available **appropriation, borrowing** and **contract authority** at the end of the period, any restrictions on the use of unobligated balances of **budget authority**, the amount of any capital infusion during the period, etc.; and (3) **outlays**. In addition, the entities are required to provide this information for each of their major budget accounts as supplementary information.

⁹ SFFAS 7 (pars. 80-82) also requires a reconciliation of budgetary obligations and proprietary accounting information, which is presented in the SOF. The reconciliation explains the relationship between (1) budgetary resources obligated by the entity during the period and **other financing sources** such as **imputed financing**, transfers of assets, etc., not included in budget receipts, and (2) the net cost of operations.

¹⁰ “Exchange revenue” arises when an entity provides goods and services for a price. “Non-exchange revenue” arises primarily from the exercise of the government’s sovereign power to demand payment from the public, such as taxes, duties, fines, etc.

are provided through the budget process and are largely **financing sources** other than revenue. **Appropriations** and other budget authority provide an agency with the authority to incur obligations to acquire goods and services or to provide benefits and grants. Budgetary resources are not earned by an entity's operations and have a different character than both exchange revenue and non-exchange revenue.¹¹ Federal entities report as an asset their fund balance with Treasury, which is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. This is an intra-government item. From the perspective of the Government as a whole, it is not an asset. It represents a commitment to make resources available to federal departments, agencies, programs, etc.¹²

24. The budget process provides the principal basis for planning and controlling obligations and outlays by Government entities. Budget execution tracks the flow of budgetary resources from the congressional authorizing and appropriating process, to **apportionment, allotment**, and obligation of the budgetary resources, to the outlay of cash to satisfy those obligations. For the most part, obligations and cash, rather than **accrual accounting**, are the bases for budgeting and reporting on budget execution.¹³
25. Accrual accounting is the basis for **proprietary accounting** in the Federal Government. Proprietary accounting and **budgetary accounting** are complementary. Proprietary accounting provides an understanding of the entity's net position and cost of operations during a period. Federal Government financial statements have not been used for planning and control as much as they might be. In part, this is because general purpose financial reports have not presented budget information with the financial statements in a way that helped users relate these two important, but different, types of financial information.¹⁴ The Board's objective in requiring new statements in the CFR addresses this issue.

¹¹ SFFAS 7, par. 24.

¹² SFFAS 1, par. 31.

¹³ SFFAS 7, par. 25.

¹⁴ SFFAS 7, par. 26.

The Government as a Whole Should Provide Information about Net Operating Revenue (or Cost), the Budget Surplus (or Deficit), and Cash

26. The information now required in two new statements serves the basic objectives of federal accounting. Objective 1¹⁵ provides that federal financial reporting should assist in fulfilling the Federal Government's duty to be publicly accountable for the money raised through taxes and other means, and for their expenditure in accordance with the appropriation laws. Sub-objective 1C provides that federal financial reporting should provide information that helps the reader to determine how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.
27. In a new statement of concepts issued contemporaneously with this standard, the Board recognizes that the CFR should be understandable to the average citizen. The new statements required in this standard were designed with this objective in mind.
28. Although budgetary and proprietary accounting information are complementary, both the types of information and the timing of their recognition are different, caused by differences in the basis of accounting.¹⁶
29. The new statements required by this standard focus on three important elements: (1) the net operating revenue (or cost) from the proprietary accounting system, (2) the unified budget surplus (or deficit), and (3) the change in the Government's cash during the period. The information is presented in two parts: (1) a reconciliation of the net operating revenue (or cost) to the unified budget surplus (or deficit), and (2) a statement of changes in cash balance from budget and other activities.
30. The purpose of the reconciliation information is to report how the proprietary net operating revenue (or cost) and the unified budget surplus (or deficit) relate to each other. The premise of the reconciliation is that the proprietary and budget accounting bases share much data. The reconciliation presents the differences between

¹⁵ SFFAC 1, pars. 112, 119.

¹⁶ SFFAC 7, par. 80.

the two systems as reconciling items while moving from the proprietary amount to the unified budget surplus or deficit.

31. The primary purpose of the statement of changes in cash balance from budget and other activities is to report how the annual unified budget surplus/deficit relates to the change in the Government's cash balance and debt held by the public. It explains why the unified budget surplus or deficit normally would not result in an equivalent change in the Government's cash balance.
32. All of the respondents who addressed the issue agreed that the new information should be required. Most of these respondents offered some comments on one or both of the proposed illustrations.
33. With respect to the terminology used in the statements, several respondents said that the term "budget" was unclear. One respondent noted that the statements use the unified budget concept, i.e., both on- and off-budget activity is included. The respondent noted that there are several other alternative approaches, including on-budget only, the President's proposed budget, and the enacted budget. Another respondent noted that, in the non-Federal environment, a budget is a plan, but for the illustrative statements it indicates actual results on a budget accounting basis. Also, several respondents objected to the use of the term "budget surplus" as being inaccurate since there is no surplus on hand to finance future activities at the reporting date, as the statement illustrates; and, that the word "surplus" has been eliminated from private sector accounting terminology.
34. The Board has modified the terminology based on these comments. The word "unified" now accompanies "budget surplus or deficit" wherever that phrase is used. In addition, the word "actual" has been added to the budget line items in the statements.
35. With respect to the term "budget surplus," the Board notes that the term is used pervasively in Federal finance and in the popular media. It is defined comprehensively in budget publications. The Board believes that most users of the CFR have at least a working understanding of the term as an excess of the fiscal year's budget receipts over budget outlays. The statement of changes in cash balance from budget and other activities will illustrate how the surplus (or deficit) and other activity affected the Government's cash balance. The glossary for this standard will provide the definition.

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36. With respect to the illustrative statement about changes in the cash balance (Appendix C in the exposure draft of March 2002, Versions A and B therein), most respondents who addressed the question preferred Version B. They said that it would be more understandable to the intended users because its groupings and subtotal were more logical.
 37. One respondent said the FASAB should provide detailed authoritative guidance regarding the format of the reconciliation and cash statements before requiring them. The respondent was concerned that the reporting requirements are not fully developed, and that the FASAB should not require such information until it develops and prescribes an authoritative format. The Board weighed the benefits of prescribing the format of the statements against the drawbacks of placing constraints on the Treasury Department's future development of the statements. The Board believes that it is better at this time to be flexible so that the most meaningful display can evolve.
 38. Another respondent asked the Board to clarify that the new statements would be principal financial statements. Additional wording to this effect has been added to the standard.
 39. Several respondents urged the Board to tie the change in cash on the new statement of changes in cash balance to the balance sheet line item and accompanying note disclosure, and/or to include beginning and ending cash balances on the statement. The Board decided that such information would improve the statement and has included it in the illustration in the standard, but does not believe that it is necessary to require it as part of the standard.
 40. One respondent said there should be some direct reference to the stewardship information on the balance sheet similar to the reference to the notes because this would inform the reader about important information not included on the balance sheet. Also, this respondent submitted that the term "National Debt" is unclear. Although the Board does not view this standard as a vehicle to address these concerns, it acknowledges the need for additional clarity and user friendliness for the CFR. The Board notes that the Treasury Department continues to improve the CFR, including the presentation of stewardship information.

Implementation Date

41. Several respondents said that the FY 2002 implementation date for the statements would afford insufficient time to prepare the new statements. However, since the Treasury Department was a leader in developing the statements and is able to prepare them in FY 2002, and since no additional information is required from component entities, this should not be an issue.

Appendix B: Illustrative Statement: Reconciliation

(Hypothetical data)		
RECONCILIATION OF NET OPERATING REVENUE (OR COST)		
AND UNIFIED BUDGET SURPLUS (OR DEFICIT)		
for the period ending Sept. 30, 20X2		
(in billions of dollars)		
<i>[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]</i>		
	FY 20X2	FY 20X1
Net operating revenue or (cost)	46.0	(50.0)
<i>Components of net operating revenue (or cost) not part of the of the budget surplus:</i>		
Add excess of accrual-basis expenses over budget outlays:		
Civilian & military employee benefits (Note X1)		
Pensions and retired pay	75.5	74.0
Retiree health benefits	14.6	14.7
Other benefits	4.7	4.6
Subtotal -- civilian & military employee benefits	94.8	93.3
Veteran compensation (Note X1)	62.5	59.0
Environmental clean-up (Note X2)	19.6	18.5
Other benefit programs (Note X3)	4.0	4.5
Other	18.5	17.5
Subtotal -- excess of accrual-basis expenses over budget outlays	199.4	192.8
Add amortized expenses not included in budget outlays:		
Depreciation (Note X7)	15.4	15.0
Add other expenses that are not reported as budget outlays:		
Premiums paid on buyback of Treasury debt (Note X10)	5.5	1.6
Subtract excess of accrual-basis revenue over budget receipts:		
Accrued tax revenue (Note X5)	(0.6)	(0.7)
Other accrued revenue (Note X8)	-	1.0
Subtract other revenue and gains that are not budget receipts:		
Other revenue and gains	(2.3)	(2.2)
Subtotal: components of net operating revenue (cost) not part of budget surplus	217.4	207.5
<i>Components of the budget surplus that are not part of net operating revenue (or cost):</i>		
Add budget receipts not included in net operating revenue (or cost):		
Principal repayments on pre-credit reform loans	24.0	24.5
Decrease in accounts receivable (Note X3)	2.7	3.0
Subtract budget outlays not included in net operating revenue (or cost):		
Acquisition of capital assets (Note X7)	(31.6)	(43.0)
Acquisition of inventory (Note X6)	(11.9)	(12.0)
Acquisition of other assets	(5.4)	(7.0)
Subtotal -- components of the budget surplus that are not part of net operating revenue (or cost)	(22.2)	(34.5)
<i>Other:</i>		
Prior period adjustment (Note X17)	(4.2)	-
Unified budget surplus (deficit) -- actual	237.0	123.0

Appendix C:
 Illustrative
 Statement:
 Statement of
 Changes in Cash
 Balance

STATEMENT OF CHANGES IN CASH BALANCE		
FROM UNIFIED BUDGET AND OTHER ACTIVITIES		
for the Years Ended September 30, 20X2 and 20X1		
(in billions of dollars)		
[Hypothetical Data]		
<i>[Footnotes below would be to notes to the financial statements and are not provided for this illustration.]</i>		
	20X2	20X1
CASH FLOW FROM UNIFIED BUDGETED ACTIVITIES		
Total unified budgetary receipts -- actual	2,025.0	1,827.0
Total unified budgetary outlays -- actual	(1,788.0)	(1,703.0)
Unified budget surplus (or deficit) -- actual	237.0	124.0
Adjustments for non-cash outlays included in the unified budget:		
Interest accrued on Treasury debt held by the public	186.0	185.0
Subsidy expense accrued under direct loan & guarantee programs (Note X1)	3.0	4.0
Subtotal - adjustment for non-cash transactions in unified budget	189.0	189.0
CASH FLOW FROM ACTIVITIES NOT INCLUDED IN UNIFIED BUDGET		
<i>Inflows:</i>		
Repayment of principal on direct loans	19.0	15.0
Decrease/(increase) in miscellaneous assets (Note X2)	1.6	(1.6)
Seignorage	2.3	2.2
<i>Outflows:</i>		
Interest paid by Treasury on debt held by the public	(184.4)	(187.8)
New direct loans disbursed	(40.0)	(34.0)
Other direct loan transactions	(0.7)	(1.0)
Premium on buyback of Treasury debt held by the public (Note X3)	(5.5)	-
Default payments on guaranteed loans	(4.3)	(5.0)
Other guaranteed loan transactions	(0.5)	(0.3)
Increase/(decrease) in deposit fund liability balances (Note X4)	(1.2)	0.1
Increase/(decrease) in miscellaneous liabilities (Note X4)	(0.9)	0.5
Cash flow from non-budget activities	(214.6)	(211.9)
Cash Flow from Monetary Transactions		
Decrease in reserve position in the IMF (Note X5)	6.3	1.2
Decrease in loans to the IMF	-	0.5
Increase in special drawing rights (Note X5)	(4.0)	(2.2)
(Increase)/decrease in other monetary assets (Note X5)	(0.9)	0.4
Cash flow from monetary transactions	1.4	(0.1)
Cash Flow from Financing		
Borrowing from the public (Note X6)	2,010.8	2,002.0
Repayment of debt held by the public (Note X6)	(2,233.5)	(2,090.0)
Cash flow from financing	(222.7)	(88.0)
Increase (decrease) in cash balance	(9.9)	13.0
Beginning cash balance (Note X7)	52.7	39.7
Ending cash balance (Note X7)	42.8	52.7

**Appendix D:
Statement Of
Budgetary
Resources (from
OMB Bulletin 01- 09,
September 25, 2001)**

**APPENDIX D: STATEMENT OF BUDGETARY RESOURCES (from OMB Bulletin 01- 09,
September 25, 2001)**

Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 1 of 2)
For the Years Ended September 30, 20x2 and 20x1
(in dollars/millions)

	20x2	20x2	20x1	20x1
	Budgetary	Non-Budgetary Credit Program Financing Accounts	Budgetary	Non-Budgetary Credit Program Financing Accounts
Budgetary Resources:				
1. Budget authority:				
1a. Appropriations received	\$ xxx	\$ xxx	\$ xxx	\$ xxx
1b. Borrowing authority	xxx	xxx	xxx	xxx
1c. Contract authority	xxx	xxx	xxx	xxx
1d. Net transfers (+/-)	xxx	xxx	xxx	xxx
1e. Other	xxx	xxx	xxx	xxx
2. Unobligated balance:				
2a. Beginning of period	xxx	xxx	xxx	xxx
2b. Net transfers, actual (+/-)	xxx	xxx	xxx	xxx
2c. Anticipated Transfers balances	xxx	xxx	xxx	xxx
3. Spending authority from offsetting collections:				
3a. Earned				
1. Collected	xxx	xxx	xxx	xxx
2. Receivable from Federal sources	xxx	xxx	xxx	xxx
3b. Change in unfilled customer orders				
1. Advance received	xxx	xxx	xxx	xxx
2. Without advance from Federal sources	xxx	xxx	xxx	xxx
3c. Anticipated for rest of year, without advances	xxx	xxx	xxx	xxx
3d. Transfers from trust funds	xxx	xxx	xxx	xxx
3e. Subtotal	xxx	xxx	xxx	xxx
4. Recoveries of prior year obligations	xxx	xxx	xxx	xxx
5. Temporarily not available pursuant to Public Law	xxx	xxx	xxx	xxx
6. Permanently not available	xxx	xxx	xxx	xxx
7. Total Budgetary Resources	\$ <u>x,xxx</u>	\$ <u>x,xxx</u>	\$ <u>x,xxx</u>	\$ <u>x,xxx</u>

Department/Agency/Reporting Entity
COMBINED STATEMENT OF BUDGETARY RESOURCES (page 2 of 2)
 For the Years Ended September 30, 20x2 and 20x1
 (in dollars /millions)

	20x2	20x2	20x1	20x1
	<u>Budgetary</u>	Non-Budgetary Credit Program <u>Financing Accounts</u>	<u>Budgetary</u>	Non-Budgetary Credit Program <u>Financing Accounts</u>
Status of Budgetary Resources:				
8. Obligations incurred:				
8a. Direct	\$ xxx	\$ xxx	\$ xxx	\$ xxx
8b. Reimbursable	xxx	xxx	xxx	xxx
8c. Subtotal	xxx	xxx	xxx	xxx
9. Unobligated balance:				
9a. Apportioned	xxx	xxx	xxx	xxx
9b. Exempt from apportionment	xxx	xxx	xxx	xxx
9c. Other available	xxx	xxx	xxx	xxx
10. Unobligated balance not available	xxx	xxx	xxx	xxx
11. Total Status of Budgetary Resources	<u>x.xxx</u>	<u>x.xxx</u>	<u>x.xxx</u>	<u>x.xxx</u>
Relationship of Obligations to Outlays:				
12. Obligated balance, net, beginning of period	xxx	xxx	xxx	xxx
13. Obligated balance transferred, net (+/-)	xxx	xxx	xxx	xxx
14. Obligated balance, net, end of period:				
14a. Accounts receivable	xxx	xxx	xxx	xxx
14b. Unfilled customer orders from Federal sources	xxx	xxx	xxx	xxx
14c. Undelivered orders	xxx	xxx	xxx	xxx
14d. Accounts payable	xxx	xxx	xxx	xxx
15. Outlays:				
15a. Disbursements	xxx	xxx	xxx	xxx
15b. Collections	xxx	xxx	xxx	xxx
15c. Subtotal	xxx	xxx	xxx	xxx
16. Less: Offsetting receipts	xxx	xxx	xxx	xxx
17. Net Outlays	<u>\$ x.xxx</u>	<u>\$ x.xxx</u>	<u>\$ x.xxx</u>	<u>\$ x.xxx</u>

**Appendix E:
Statement Of
Financing (from
OMB Bulletin 01-09,
September 25, 2001)**

APPENDIX E: STATEMENT OF FINANCING (from OMB Bulletin 01-09, September 25, 2001)		
Department/Agency/Reporting Entity CONSOLIDATED STATEMENT OF FINANCING (Page 1 of 2) For the Years Ended September 30, 20x2 and 20x1 (in dollars /millions)		
	20x2	20x1
<i>Resources Used to Finance Activities:</i>		
Budgetary Resources Obligated		
1. Obligations incurred	\$ xxx	\$ xxx
2. Less: Spending authority from offsetting collections and recoveries	xxx	xxx
3. Obligations net of offsetting collections and recoveries	xxx	xxx
4. Less: Offsetting receipts	xxx	xxx
5. Net obligations	xxx	xxx
Other Resources		
6. Donations and forfeitures of property	xxx	xxx
7. Transfers in/out without reimbursement (+/-)	xxx	xxx
8. Imputed financing from costs absorbed by others	xxx	xxx
9. Other (+/-)	xxx	xxx
10. Net other resources used to finance activities	xxx	xxx
11. <i>Total resources used to finance activities</i>	x,xxx	x,xxx
<i>Resources Used to Finance Items not Part of the Net Cost of Operations</i>		
12. Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided (+/-)	xxx	xxx
13. Resources that fund expenses recognized in prior periods	xxx	xxx
14. Budgetary offsetting collections and receipts that do not affect net cost of operations		
14a. Credit program collections which increase liabilities for loan guarantees or allowances for subsidy	xxx	xxx
14b. Other	xxx	xxx
15. Resources that finance the acquisition of assets	xxx	xxx
16. Other resources or adjustments to net obligated resources that do not affect net cost of operations (+/-)	xxx	xxx
17. <i>Total resources used to finance items not part of the net cost of operations</i>	xxx	xxx
18. <i>Total resources used to finance the net cost of operations</i>	x,xxx	x,xxx

Department/Agency/Reporting Entity
 CONSOLIDATED STATEMENT OF FINANCING (Page 2 of 2)
 For the Years Ended September 30, 20x2 and 20x1
 (in dollars /millions)

	20x2	20x1
<i>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</i>		
Components Requiring or Generating Resources in Future Periods:		
19. Increase in annual leave liability	xxx	xxx
20. Increase in environmental and disposal liability	xxx	xxx
21. Upward/Downward reestimates of credit subsidy expense (+/-)	xxx	xxx
22. Increase in exchange revenue receivable from the public	xxx	xxx
23. Other (+/-)	xxx	xxx
24. Total components of Net Cost of Operations that will require or generate resources in future periods	xxx	xxx
Components not Requiring or Generating Resources:		
25. Depreciation and amortization	xxx	xxx
26. Revaluation of assets or liabilities (+/-)	xxx	xxx
27. Other (+/-)	xxx	xxx
28. Total components of Net Cost of Operations that will not require or generate resources	xxx	xxx
29. <i>Total components of net cost of operations that will not require or generate resources in the current period</i>	<u>x,xxx</u>	<u>x,xxx</u>
30. <i>Net Cost of Operations</i>	<u>x,xxx</u>	\$ <u>x,xxx</u>

Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Statement of Federal Financial Accounting Standards 25: Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment

Status

Issued	July 2003
Effective Date	Reclassifies "Risk Assumed" information and eliminates the "Current Services Assessment" for reporting periods that begin after September 30, 2002. Reclassifies the "Statement of Social Insurance" and other information about social insurance for reporting periods that begin after September 30, 2004.
Volume II References	Current Services Assessment (C80), Social Insurance (S40), Risk Assumed (I40)
Interpretations and Technical Releases	None.
Affects	<ul style="list-style-type: none">• SFFAS 5, summary, paragraph 106, paragraph 186, paragraph 190• SFFAS 8 summary, paragraph 14-16; appendix B• SFFAS 17 summary, paragraph 27 (3), paragraph 32(3)
Affected by	<ul style="list-style-type: none">• SFFAS 26 rescinded paragraph 6.• SFFAS 28 rescinded parts of paragraph 7.

Summary

This Statement of Federal Financial Accounting Standards (SFFAS) changes the classification of information about stewardship responsibilities required by federal accounting standards. It also eliminates the requirement to present certain information about stewardship responsibilities, known as the "Current Services Assessment," previously required by SFFAS 8.

Scope of this Statement

This Statement deals with

- **Risk Assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*
- The **Current Services Assessment (CSA)** required by SFFAS 8, *Supplementary Stewardship Reporting*, and
- **Social Insurance** information required by SFFAS 17, *Accounting for Social Insurance*.

Information about stewardship responsibilities is currently designated Required Supplementary Stewardship Information (RSSI), a category unique to federal financial reporting. Pursuant to this SFFAS, information about Risk Assumed will become required supplementary information (RSI). The Statement of Social Insurance (SOSI) will become a basic financial statement, while the remaining information about Social Insurance required by SFFAS 17 is addressed in SFFAS 26 as amended by SFFAS 28.

Reasons for Issuing this Statement

For reasons explained in Appendix A, the Board decided to review the classification of all RSSI required by federal accounting standards. The Board eliminated use of RSSI to report information about weapons systems when it issued SFFAS 23, Eliminating the Category “National Defense Property, Plant, and Equipment.” Classification of other items of information currently designated RSSI (stewardship land, stewardship investments, and heritage assets) may be dealt with in one or more future exposure drafts. The Board also decided to eliminate the requirement to present the CSA now, because timely issuance of federal financial reports, a practice that was not possible when SFFAS 8 was published, will make it infeasible to present the CSA in the Government’s annual financial report. The same information will, however, continue to be publicly available in the Budget of the United States Government.

How the Changes in this Statement Improve Federal Financial Reporting

These changes will improve the clarity and significance of federal financial reporting in two ways: (1) by defining the SOSI as essential to fair presentation and (2) by using reporting categories that are well defined in existing professional literature and familiar to report users.

The Effective Date

The requirement to report the CSA will be eliminated effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002.

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Abbreviations

AGA	Association of Government Accountants
AICPA	American Institute of Certified Public Accountants
AT	Attestation Standards codified and published by AICPA
AU	Audit Standards codified and published by AICPA
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government (formerly the “CFS”)
CMS	Centers for Medicare and Medicaid Services (formerly HCFA)
CSA	Current Services Assessment
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	General Accounting Office
GASB	Governmental Accounting Standards Board
OAI	Other Accompanying Information (also known as “other supplementary information” – i.e., supplementary information not required by GAAP)
OMB	Office of Management and Budget
PCIE	President’s Council on Integrity and Efficiency (Inspectors General)
RSI	Required Supplementary Information (as used in SFAS 25 and other accounting standards and in AU Section 558)
RSSI	Required Supplementary Stewardship Information (as used in SFFAS 5, 8 and 17)
SFAC	Statement of Financial Accounting Concepts
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
SSA	Social Security Administration

Introduction

1. Federal accounting standards require the following information to be reported regarding stewardship responsibilities:
 - **Risk Assumed** information required by SFFAS 5, *Accounting for Liabilities of the Federal Government*,
 - The **Current Services Assessment** (CSA) required by SFFAS 8, *Supplementary Stewardship Reporting*, and
 - **Social Insurance** information required by SFFAS 17, *Accounting for Social Insurance*.
2. This information is currently designated Required Supplementary Stewardship Information (RSSI). RSSI is a reporting category unique to federal accounting. Pursuant to this Statement, Risk Assumed information will become required supplementary information (RSI)¹, and the CSA will not be required after FY 2002. For FY 2005 the Statement of Social insurance (SOSI) will become a basic financial statement, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Other Social Insurance information required by SFFAS 17 shall be presented as RSI rather than as RSSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements. Appendix A presents background information and the reasons for these changes.
3. This Statement amends SFFAS 5 and SFFAS 17 by reclassifying Risk Assumed information and Social Insurance information. Those standards would remain unchanged in all other respects. The requirement in SFFAS 8 to report the CSA is rescinded.

¹ RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, the Governmental Accounting Standards Board (GASB), and the FASAB. The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by AICPA.

Standards of Federal Financial Accounting

Risk Assumed	4. Information about Risk Assumed, required by SFFAS 5 and previously designated required supplementary stewardship information (RSSI), shall be designated required supplementary information (RSI).
Current Services Assessment	5. Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8.
Social Insurance	6. [Rescinded by SFFAS 26.]
Effective Date	7. Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8, effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002.

The provisions of this statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix summarizes the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background	8. In SFFAS 8, FASAB stated:
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A key aspect of the stewardship objective requires that Federal reporting provide information that helps users determine (1) whether the Government's financial condition improved or deteriorated over the period and (2) whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

Information on 'stewardship responsibilities' will aid in these determinations. It will provide an essential perspective on the Government's commitment to discretionary and mandatory programs.²

These objectives have not changed. However, for reasons discussed below, the Board believes that information about stewardship responsibilities should be reported in the context of the basic financial statements, the associated notes,³ and required supplementary information, rather than as RSSI. The Board eliminated use of RSSI to report information about weapons systems when it issued SFFAS 23, *Eliminating the Category "National Defense Property, Plant, and Equipment."* The Board will consider in other projects the proper classification of other items that are now classified as RSSI.

9. The Board originally contemplated that GAO and OMB would provide special guidance regarding the audit procedures or "fieldwork" to be performed on RSSI. At the same time, the Board expected that the auditor would report on this information in much the same way as on the basic financial statements, in the sense that the auditor would qualify or disclaim an opinion when the RSSI was omitted or materially misstated. The category was seen as a response to the unique aspects of the federal accounting and reporting environment, and to the broad objectives of federal financial reporting. It was intended to permit flexibility on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information.⁴

² SFFAS 8, paragraphs 14 and 15.

³ The notes are regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with GAAP.

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10. Some members became concerned that users: (1) may pay insufficient attention to some important information because it is called “supplementary,” and (2) may be confused by complicated reports in which information is reported in various places. They believed this might impede users’ understanding and reduce the credibility of federal financial reports. Some members believed that FASAB’s use of the RSSI category invites suspicion of accounting in which items that are as important as the basic financial statements are labeled “supplementary.” Accordingly, in *Preliminary Views on Eliminating the Category “Required Supplementary Stewardship Information”* (December 2000), the Board proposed to eliminate the RSSI category by reviewing and reconsidering the appropriate classification of each item classified as RSSI.
 11. In deciding to review the classification of components of RSSI, some members were influenced by the fact that existing audit standards do not discuss RSSI. Therefore, auditors do not know what to do with respect to information in this category without consulting federal publications that provide additional guidance on how to conduct or contract for audits of federal financial statements. Furthermore, as practice evolved, it was not clear that auditors would qualify or disclaim their opinion on the basic financial statements when RSSI was missing or misstated, because it was not clear to everyone that the information was essential to fair presentation in conformity with GAAP. Some FASAB members were concerned that, under these circumstances, even sophisticated users might not understand fully the significance of certain information classified as RSSI. Some members believed that it would be desirable for FASAB to use categories that are widely understood by the broader accounting and auditing professions, particularly now that FASAB has been recognized by AICPA as the body that promulgates generally accepted accounting principles for the federal government.
 12. The Board received 29 written comments on its December 2000 *Preliminary Views* from the following sources:

⁴See the *Implementation Guide to Statement of Federal Financial Accounting Standards No. 7: Accounting for Revenue and Other Financing Sources*, June 1996, paragraphs 22-24, the diagram on page 15, and minutes of associated Board discussions. See also SFFAS 8, *Supplementary Stewardship Reporting*, June 1996, paragraphs 21, 34, 111-115, and minutes of associated Board discussions.

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- 16 preparers (all federal),
 - 8 auditors (three nonfederal, including AICPA),
 - 5 others. (This category includes academics, retired federal employees, and the Association of Government Accountants (AGA), a professional association of federal and nonfederal accountants and auditors.)
13. The comments reflected the views of more than 29 people. Comments from the President's Council on Integrity and Efficiency (PCIE), AGA, federal agencies, and AICPA were the work of numerous individuals. Twenty of the respondents would have retained the RSSI category, at least for some period. Some typical concerns expressed include the following:
- Elimination of the category would provide less stewardship information to users, lead to a qualified opinion that would send a less-clear signal to users than is available with current and potential alternatives, and raise audit costs. The category provides a clear and unique method to prominently display stewardship information essential to meeting taxpayer accountability. The category has been successful in communicating our financial condition.
 - The separate category and section of the report is an effective and practical means of reporting. It is appropriate for the unique environment and objectives of federal financial reporting. Approaches to providing audit assurance over RSSI are evolving. FASAB should work with specialists in the relevant disciplines to define common units of reporting for items not expressed in monetary terms.
 - Unique aspects of the federal financial reporting environment and objectives led the Board to create the new category. If used properly, the category should be a mechanism to provide much-needed information to decision makers, including citizens, when they consider the consequences of decisions relating to public lands, heritage assets, and similar items.
14. In April 2001 the Board held a public hearing to discuss the *Preliminary Views* proposal with interested parties. Fourteen individuals, representing seven organizations, made presentations and discussed issues with the Board. Comments were similar to those expressed in the 29 comment letters.
15. After considering these comments, the Board continued to believe that federal accounting standards may be able to address the objectives of

federal financial reporting, including accountability and reporting on stewardship, without a unique category. The Board noted that eliminating the RSSI category need not result in a reduction of information required by existing standards. (The Board subsequently decided to rescind the requirement to present the CSA in the annual consolidated financial report of the U.S. Government (CFR) for other reasons, which are explained on page, but the information will continue to be available to the public). Furthermore, the Board noted, preparers will continue to have the option of voluntarily presenting supplementary information beyond what is required. This “other accompanying information” would be unaudited, unless special arrangements were made to extend the auditor’s work in the context of a particular audit.

16. The Board continued to believe that avoiding use of the RSSI category where it is not essential would eliminate some potential confusion and ambiguity. In particular, it should clarify the Board’s expectation that when material information that is essential to fair presentation is missing or materially misstated, the auditor should consider whether a qualified or adverse opinion is appropriate regarding whether the basic financial statements are prepared in conformity with GAAP. After consultation with AICPA staff, the Board concluded that this result could best be assured by designating such information as an integral part of the basic financial statements.
17. Accordingly, in February 2002, the Board published an exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*. The exposure draft proposed to eliminate the Current Services Assessment, reclassify information about Risk Assumed as RSI, and reclassify all Social Insurance information as an integral part of the basic financial statements. The Board received 22 comment letters from the following sources:
 - 11 preparers (all federal),
 - 7 auditors (6 federal and AICPA),
 - 4 others. (This category includes an academic, two former Board members, and the AGA.)
18. Some letters reflected the views of an organization, while others were from individuals. Comments generally supported or did not oppose eliminating the CSA and reclassifying Risk Assumed information as

RSI. Some letters did express concern about the feasibility of auditing Social Insurance information as an integral part of the basic financial statements and/or questioned whether the benefit of doing so would outweigh the cost. In response to these concerns, the Board consulted with representatives of AICPA, and decided (1) to designate only the SOSI as a basic financial statement, while classifying other Social Insurance information as RSI, and (2) to extend the time allowed to implement this change. More detailed explanation of the basis for the Board's conclusions follows.

Conclusions Regarding Each Type of Stewardship Responsibility Information

19. Figure 2 on page 1027 presents a list of general factors that one or more Board members considered relevant for the classification choices. Specific decisions on each of the three types of stewardship responsibility information are discussed in the remainder of this Appendix.

Risk Assumed

20. The Board agreed that information about Risk Assumed should be RSI rather than an integral part of the basic financial statements, because the amounts are not sufficiently reliable and measurement methods are still experimental. This information is potentially valuable, but it is not yet a suitable basis for recognition or disclosure.⁵ The Office of Management and Budget (OMB), the Government Accountability Office (GAO), and the Congressional Budget Office (CBO) have considered the use of Risk Assumed information as a basis for budgeting for insurance programs. These agencies have concluded that more experience is needed before the measurements can be regarded as sufficiently reliable for budgeting. Similar considerations lead the FASAB to conclude that information about Risk Assumed should be included in financial reports as RSI, at least until agencies and auditors have more experience with this information.

⁵ FASAB uses the term "disclosure" to refer to information that is not recognized on the face of the basic financial statements but is regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Normally such disclosures are presented in footnotes, but federal accounting standards published by FASAB do not currently prescribe the format for presentation of such disclosures. GAAP does not prohibit formatting or combining pieces of information in appropriate ways to direct the reader's attention, provided that the results are not misleading.

Current Services
Assessment (CSA)

21. The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables. The Board believes that additional guidance from FASAB on definition and measurement of “Risk Assumed” would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements. Developing and promulgating such guidance would require a separate project. Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies’ data systems and modeling capabilities to support reporting Risk Assumed. The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner. The Board notes that the “state of the art” for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop more specific criteria for reporting Risk Assumed, the Board will be able to learn from this ongoing experience.
22. The CSA provides receipt and outlay data on the basis of the President’s projections of future activities pursuant to current law. It is relevant for assessing the sustainability of programs established by current law; that is, relevant for assessing the sufficiency of future resources to sustain public services and to meet obligations as they come due. The CSA focuses on the totality of government operations rather than on individual programs. It provides an analytical perspective on the Government because it shows the short- and long-term direction of current programs.
23. SFFAS 8 defines the CSA by reference to what is published in the President’s Budget. The Board did not then foresee the possibility that the CFR would be published before the Budget. Because the Board now expects that within a few years the CFR will be published before the President’s Budget is available, the requirement to include the CSA in the CFR will expire in FY 2002 (i.e., the CSA will not be required in the CFR after FY 2002). In order to continue to require something comparable to the CSA as part of the CFR when the CFR is published before the Budget, federal accounting standards would need to define the CSA in some way other than by reference to the Budget. Developing the criteria for such a projection is beyond the scope of this project.

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24. The Board considered the alternative of including OMB's current services estimates prepared for the "midsession review." The Board concluded that certain technical problems would make this alternative problematic. Furthermore, supplementary reporting on this basis would not add value, because the estimates are publicly available in any event, and because the base year actual data published in the budget would not be subject to review by the auditor.
 25. The Board notes that OMB, CBO, and others regularly publish similar projections; therefore, similar information will continue to be available, regardless of whether it is required to be part of the CFR. The Board also notes that the "state of the art" for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop criteria for such a projection as a part of federal financial reporting, the Board will be able to learn from this ongoing experience.

Social Insurance

26. The Board believes that the SOSI should be treated as a basic financial statement because it is essential to fair presentation and is important to achieve the objectives of federal financial reporting. The related stewardship objectives include helping users to assess the impact on the country of the Government's activities, determine whether the Government's financial position improved or deteriorated over the period, and predict whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due. In that regard, the multi-trillion dollar obligations associated with Social Insurance over the next 75 years could significantly exceed the largest liabilities currently recognized in the U.S. Government Balance Sheet.
27. The Board acknowledges that there is great uncertainty inherent in long term projections, but believes that if the uncertainty is suitably disclosed--as is required by SFFAS 17--it need not preclude designating the information as a basic financial statement, essential for fair presentation in conformity with GAAP. The Board rejects the idea that information based on projections cannot be an integral part of the basic financial statements. FASAB has not limited the content of federal financial statements to historical information.
28. Even within the context of historical financial reporting, the Board notes that accrual-basis "historical" financial statements include many

measurements that involve assumptions about the future. The distinction between reporting on the financial effects of events that have occurred and the effects of future events depends, obviously, upon the definition of the event. The information required by SFFAS 17 reports on the financial effects of existing law and demographic conditions and assumptions, just as the pension obligation at a point in time is based on existing conditions. In that sense, Social Insurance information can be viewed as reflecting events that have occurred and, therefore, as “historical.”

29. Measuring the future effects of existing law and conditions for Social Insurance involves projections of economic and demographic trends, just as measuring the pension benefit obligation at a point in time involves assumptions about future salary progression. It is true that SFFAS 5 specifies a different measurement method for pensions and retiree healthcare than the method SFFAS 17 specifies for Social Insurance. It is also true that Social Insurance measurements are more sensitive to assumptions about the most distant years of the projection period. Nevertheless, the Board believes that it is appropriate to report the SOSI as a basic financial statement, essential for fair presentation in conformity with GAAP.
30. Classifying the SOSI as a basic financial statement will mean that auditors will consider a modification of their opinion if this information is materially misstated. A modification would send a clear and appropriate signal to users in such a circumstance. The Board understands that some added audit expense will be incurred as a result of this change in status for Social Insurance information, and added demands may be made on the accounting and actuarial staff of agencies that report Social Insurance information. The Board believes that the benefits in this case outweigh the expense. The SOSI is important to those who would understand the Government’s financial condition and its impact on the financial condition of individual citizens, interesting to the public, and essential to fair presentation.
31. The exposure draft proposed to reclassify all Social Insurance information as an integral part of the basic financial statements. In response to concerns expressed about the cost and feasibility of auditing this information, the Board decided to define only the SOSI as a basic financial statement, and provided additional time for implementation. The impact of the change in audit status for the SOSI should be mitigated by the fact that preparers and users have

experience with similar information. Also, much of the actuarial and audit work can be done before the end of the fiscal year, if the preparer and auditor prefer. SFFAS 17 provides for considerable flexibility in selecting the measurement date. Paragraph 26 of SFFAS 17 states:

All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon (“current year”) as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

Conclusions Regarding Effective Date

32. The standard eliminates the requirement to present the CSA, and does not change the definition, presentation guidelines, or audit status for Risk Assumed information. (RSSI is currently treated as RSI for audit purposes, pursuant to instructions in OMB’s *Audit Bulletin*.) No delay is needed as a result of the changes regarding these two items. Accordingly, these changes are effective immediately.
33. Audit status for the SOSI would change; however, as noted above, the information is not new. Most of the relevant agencies have produced similar information for several years, and analysts and public officials have routinely used this information. Also, the impact of the audit requirement on the auditor and preparer should be reduced by the flexibility SFFAS 17 provides in selecting a measurement date for Social Insurance. The Board consulted with AICPA regarding the time needed to develop appropriate audit guidance. The Board also noted that federal agencies will be confronted with a challenging requirement for accelerated financial reporting in FY 2004. As a result, the Board concluded that the SOSI should be presented as a basic financial statement for reporting periods that begin after September 30, 2004, with earlier implementation encouraged.

Distinguishing RSI from the Basic Financial Statements and Associated Notes

34. To help readers understand the Board’s deliberations, this section provides more details about some practical and conceptual factors that affected the Board’s decision whether to designate an item as RSI or as an integral part of the basic financial statements. The basic financial statements include the principal financial statements and associated notes on which the auditor expresses an opinion as to

whether the information is presented in conformity with GAAP. The terms “basic financial statements” and “principal financial statements” have been used synonymously in federal accounting.

35. FASB tends to use the term “basic financial statements” or simply “financial statements” consistent with the definition in FASB Concepts Statement 5, *Recognition and Measurement in Financial Statements of Business Enterprises*:

. . . a financial statement is a formal tabulation of names and amounts of money derived from accounting records that displays either financial position of an entity at a moment in time or one or more kinds of changes in financial position of the entity during a period of time. Items that are recognized in financial statements are financial representations of certain resources (assets) of an entity, claims to those resources (liabilities and owners’ equity), and the effects of transactions and other events and circumstances that result in changes in those resources and claims. The financial statements of an entity are a fundamentally related set that articulate with each other and derive from the same underlying data. (SFAC 5, paragraph 5, footnote omitted.)

AICPA tends to use the term “basic financial statements” or simply “financial statements” also to encompass footnotes that are regarded as an integral part of the basic financial statements as defined in SFAC 5. Depending on the context, FASAB may use the term either way. The following discussion focuses on the distinction between information on which the auditor expresses an opinion (whether reported on the face of the basic statements or in the notes to the statements) and supplementary information that is also required by GAAP.

Operational Differences Between the Basic Financial Statements and RSI

36. Figure 1 (on page 1042) identifies some operational differences under current auditing standards. Given these operational differences between basic financial statements and RSI, the Board must determine whether it would be more appropriate for a given item of required information to be deemed an integral part of the basic financial statements or RSI. The appropriateness depends on the particular benefits (based on various federal financial reporting objectives) and the costs (preparing, auditing, user processing, other) of making it subject to audit (vs. more limited procedures) and varying the

potential audit opinion treatment (qualification vs. mere mention in the auditor's report).

Figure 1

Comparison Dimension	Basic Financial Statements	RSI
Is the information required to be in the financial report ? (That is, it is either an integral part of the basic financial statements or it must accompany them.)	Yes	Usually ^a
Is the information deemed essential if the financial statements are to "present fairly" in conformity with GAAP?	Yes	No
What audit fieldwork is required?	Audit	Limited procedures pursuant to AU 558
Auditor's report	Positive assurance regarding "fair presentation"	Silent, no explicit assurance unless engaged to audit the RSI. However, if the RSI is financial information that has been subjected to audit procedures in connection with auditing the basic financial statements, the auditor may express assurance "in relation to the financial statements taken as a whole."
What audit report mention is required if the information is missing or not prepared in conformity with guidelines?	Qualified or adverse opinion	Mention in report; no qualification of opinion on the basic financial statements.

^aIn some cases, RSI need not physically accompany the basic financial statements in the same document; certain GASB standards permit reference to another publicly-available report as an option for specified RSI.

37. It should be noted that the value of information to users and the value added by auditing it are separate, though certainly related, considerations. For example, some information may be valuable to some users, yet auditing it might add little value. On the other hand, some information (e.g., aggregated financial information for a federal agency as a whole) may not be used directly by decision makers as input to a particular "decision model," but auditing it might provide some degree of valuable assurance about other information (e.g., detailed program cost or budgetary expenditure information) or objectives of interest (e.g., internal accounting control and finance-related legal compliance). Auditing financial statements may also deter fraud and unintentional errors of various sorts in other, more timely reports.

Footnote vs. RSI Section

38. Although not required by auditing standards, RSI has customarily been located in a separate section of the financial report, to aid in distinguishing it from audited information.⁶ This practice has

continued with RSSI, evidently in part because federal preparers thought it was necessary, or at least desirable, to report “stewardship” items together. It is possible that placement of information in different sections of the financial report leads some types of readers to pay more (or less) attention to the information. Although the magnitude of these differences is an open question, research has shown that formatting can matter to individual users.

Audit Aspects of Basic vs. RSI

39. Both footnote disclosures and required supplementary information are viewed as being sufficiently relevant to be required to accompany the basic financial statements in financial reports,⁷ though only the notes are regarded as required for fair presentation in conformity with GAAP. As discussed previously, one major difference between the two

⁶ AU 558.10 states: “Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB, GASB, or FASAB. However, management may choose not to place the required supplementary information outside the basic financial statements. In such circumstances, the information should be clearly marked as unaudited. If the information is not clearly marked as unaudited, the auditor’s report on the audited financial statements should be expanded to include a disclaimer on the supplementary information.”

In practice, notes and RSI generally have not been commingled. Indeed, in discussing the location of RSI it requires, FASB said, “Reporting specialized information on oil and gas producing activities in a single location within a financial report is a desired objective of this Statement so as to make the relationship among the different types of information easier to analyze.” (FAS 69, par. 117)

In theory, RSI might be integrated with related audited information, provided the unaudited information was suitably labeled. Whether this would be feasible and desirable in practice may be debatable. Concern on the part of independent CPAs about litigation risk has been among the factors that encouraged physical separation of audited information from unaudited information.

Another practical consideration may be introduced by recent guidance from AICPA intended to clarify the auditor’s ability to offer some limited assurance “in relation to the financial statements” on certain RSI. This could imply a need to distinguish the RSI for which such assurance is offered from other types of supplementary information, both required and voluntary.

Some comments regarding FASAB’s *Preliminary Views on Eliminating the Category “Required Supplementary Stewardship Information”* suggested that some people believe there are conceptual as well as practical reasons to report different kinds of information separately.

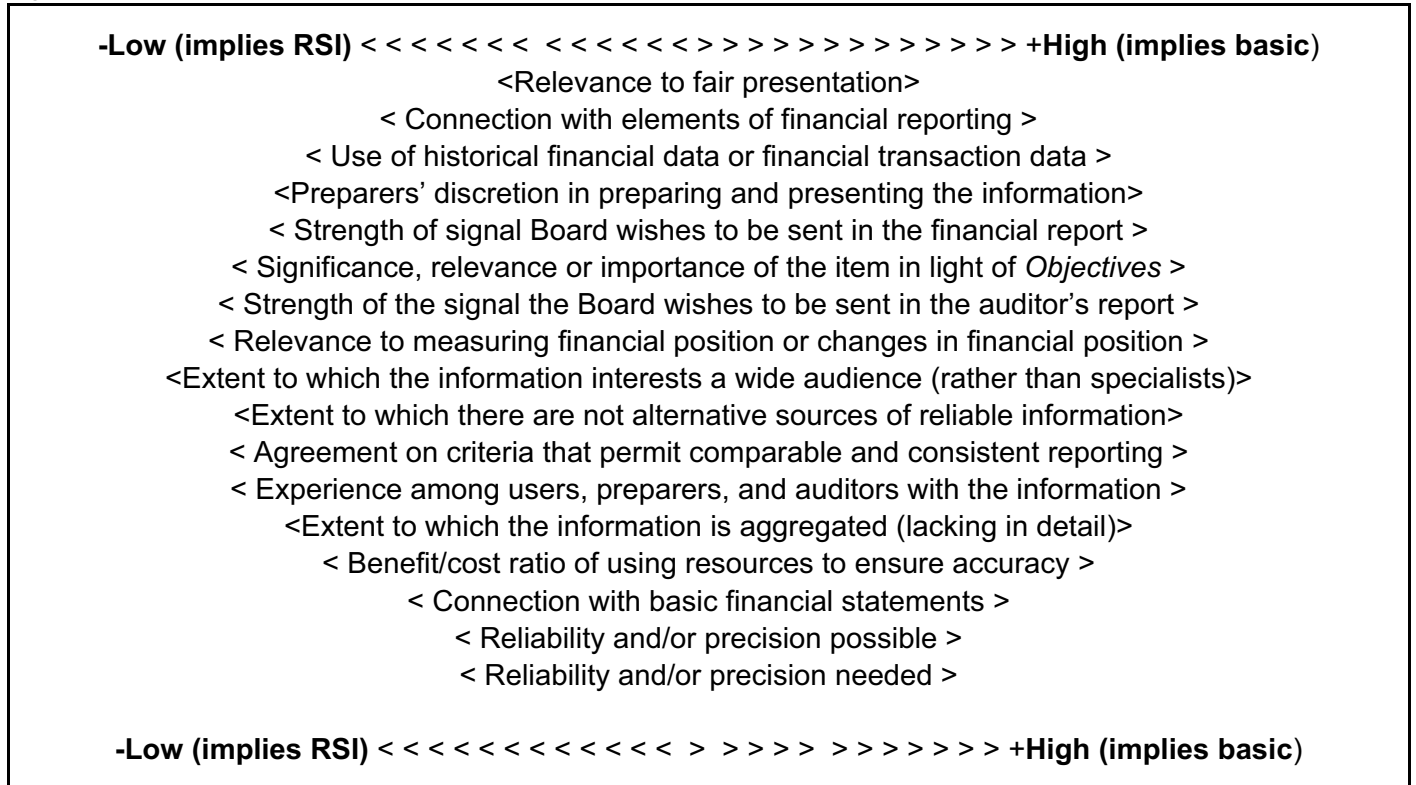
⁷ As noted, certain GASB standards permit reference to another publicly-available report as an option for specified RSI.

types of information is the extent and nature of the auditor's scrutiny and responsibility for the information; another is the nature of the auditor's report and the kind of "signal" it sends. Thus, the cost and value added by audit are factors to consider. The main question is: for what types of information, users, and objectives would the benefits of making an item an integral part of the basic financial statements instead of RSI exceed the incremental costs of audit, compared with reviewing pursuant to AU 558's limited procedures?

Factors to Consider

40. In deciding whether a given item should be classified as RSI or as an integral part of the basic financial statements, one might consider a variety of factors, such as those listed in figure 2. They are not listed in any particular order, and some "overlap" or convey similar ideas. Different people assign different weight to each factor. Some people may not consider some of the factors at all, and some people may consider factors that are not listed. Likewise, different people may evaluate each item to be reported differently on each dimension. Therefore, figure 2 is not a decision tree, hierarchy, or precise algorithm for classifying items, but a general framework for each individual's judgment.

Figure 2



41. Different people will assign different importance to each factor. However, a consensus did emerge during the Board's deliberations on the proper classification of Social Insurance information that three related factors are particularly important for that decision: (1) The Board agreed that the SOSI is "essential to fair presentation." A set of financial statements could not be said to "present fairly" when the SOSI is missing or materially misstated. For this reason, it is important (2) that this signal clearly be communicated to the reader of the financial report and (3) to the reader of the auditor's report. Other factors listed also were deemed relevant, and were deemed consistent with "basic" status; for example, a wide audience is interested in this information.

42. The Board ultimately decided to rescind the requirement to present the CSA for reasons discussed on page , but not before it considered the proper classification of the CSA. The amount of discretion available to the preparer was deemed especially important to the decision about how to classify the CSA. If there is very little discretion

in preparing the information, the value of auditing may be modest. An example is SFFAS 8's requirement to reprint information as it was presented in the *President's Budget*, without independent criteria for evaluating it. On the other hand, if there is great discretion, questions may arise about whether the resulting information would be sufficiently reliable, comparable, and consistent without auditing. Another factor, relevant both to the decision initially to classify the information as RSI and to the decision eventually to terminate the requirement, is that there are other, credible sources of similar information. As noted, OMB and CBO routinely publish intermediate and long-term projections that are scrutinized by Congress and by analysts in the private sector.

43. Because SFFAS 5 does not include detailed criteria for defining and measuring Risk Assumed, preparers have considerable discretion in calculating it. This might seem to imply that audit would be desirable. However, auditors may have concerns about expressing positive assurance on information for which specific definitions and measurement criteria have not been defined. In other words, there may not be sufficient agreement on criteria that permit comparable and consistent reporting to permit classifying Risk Assumed as an integral part of the basic financial statements. Another example where this concern has affected classification is information about the condition of stewardship assets and deferred maintenance of property, plant and equipment. Even when auditors do provide assurance, in some cases they may wish to express special qualifications, explanations, or caveats in their report. An example might be an auditor's report on an examination of prospective financial information where there is great inherent uncertainty, or an examination of other assertions by management about matters where management has great discretion.
44. Concerning the "significance" factor: The basic financial statements (including notes that are regarded as an integral part of the financial statements) and RSI are both important enough to be required items in financial reports. With respect to the audit status of the information, it would seem that, by itself, the importance of an item need not automatically imply that the information should be audited. Rather, one would also consider the extent of the information-preparer's discretion as well as the cost of auditing the information item. However, it does seem that the more important the item, the more likely it should be audited, if the information preparer had a significant

degree of discretion. One would be willing to incur more audit costs to avoid misstatement of very important information items that could affect users' decisions. Furthermore, the more important the item, the more likely it would be deemed essential to fair presentation, thus implying a need to qualify the auditor's opinion if the information were missing or misstated.

45. Concerning the "reliability and/or precision" factors: These factors are intertwined, and all affect the extent to which one would prefer audited information to RSI. "Reliability and/or precision *needed*" asks one to evaluate the users' tolerance for imprecise measures of a relevant item. Since auditing is likely to increase precision (either through inducing more precise measures by the preparer or by reducing the variance in the measures by audit procedures), the less tolerance for imprecision that users have concerning an information item, the more likely that the Board would want to make the item a required note disclosure instead of RSI.
46. "Reliability and/or precision *possible*" deals with the very nature of the information item being reported. Precision about measures of past events seems inherently more possible than precision about estimates of future events. To the extent that there is a fundamental minimum amount of imprecision in certain information items, the cost of increasing audit effort might not be justified. For some Board members, this consideration was among the factors (along with others such as cost/benefit) that imply "Risk Assumed" information should properly be classified as RSI at this time. At the same time, however, uncertainty need not preclude classifying information as an integral part of the basic financial statements when other factors indicate this is appropriate, as is the case with the SOSI. Uncertainty should be disclosed and described to the extent feasible.
47. Some other listed factors also relate to the nature of the information. For example, some people may define the domain of accounting and/or financial reporting (or categories within that domain) in terms of the nature of information involved (e.g., as limited to "historical" financial information or to certain defined "elements" of financial reporting, or to certain concepts such as "financial position"). FASB has emphasized the role of "elements of financial reporting" in defining the financial statements and notes. FASB and GASB also emphasize the concept of net assets or financial position in defining financial statements and notes.

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48. Other people may define financial reporting, and its component categories, in terms of the comparative advantage unique to reporting based on the information system for processing financial transactions. SFAC 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, says that the “financial statements . . . articulate with each other and derive from the same underlying data (par. 5). Some believe this idea is rooted in the basic “bookkeeping” paradigm of accounting (see SFFAC 1, *Objectives of Federal Financial Reporting*, paragraphs 166-168). Such a definition might be expected to lead to accounting standards that would define the basic financial statements in a narrow or traditional way, with other kinds of information (e.g., performance indicators or management’s assertions about internal control) being reported as RSI.
49. Others may define the domain of financial reporting, and categories within that domain, more broadly. A broader definition might, for example, be expressed in terms of the objectives of federal financial reporting, or the comparative advantage of the annual reporting and audit cycle, which assures the production and examination of information that GAAP say is essential to fair presentation, where GAAP reporting is mandated by law, contract, or market forces. This kind of broader definition might be expected to lead to standards that would define more types of information (e.g., performance indicators or management’s assertions about internal controls) as a part of the basic financial statements.
50. More generally, the “benefit/cost ratio of using resources to assure accuracy” asks one to assess the costs of producing auditable information and auditing it versus the benefits that could be achieved by merely preparing the information as RSI and applying the procedures specified at AU 558. Other things being equal, one would avoid auditing where the cost of auditing is quite high. Similarly, to the extent that alternative, credible sources of information exist, the cost of auditing the information may exceed its benefits.

Board Approval and Dissent

51. This Statement was adopted by the affirmative votes of seven members of the Board. Mr. Anania dissented. Mr. Kull abstained.
52. Mr. Anania dissents from this Statement because he believes the Board's decision to have the information required by Par. 27(3) and 32(3) of SFFAS 17 presented as a basic financial statement is

premature and is not supported by a change in circumstances or appropriate technical considerations by the Board.

53. The Board issued SFFAS 17 in August 1999 after more than four years of debate and consideration of many major issues including: (1) definition of a federal liability with weight given to the unique circumstances of the Federal Government, including its sovereign powers, (2) nature of Social Insurance laws and practices, (3) significance of Social Insurance programs to individual taxpayers, and (4) long-term sustainability of the programs as currently constructed.
54. In SFFAS 17, Appendix A - Basis for Conclusions - Section 2, the arguments are presented for (Par. 73-79) and against (Par. 65-72) recognition, disclosure or supplementary reporting of Social Insurance programs. The Board's conclusion (Par. 80-83) acknowledges there were two polarized views. These sentences from SFFAS 17 summarize those views and the Board's decisions related to disclosure and measurement of Social Insurance obligations:

. . . On the one side are those who believe that social insurance programs - especially Social Security and Medicare - constitute a liability of the Federal Government that should be recognized on the consolidated balance sheet and that the closed group is the best measure of it.... At the opposite pole are those who firmly believe that the closed group measure is meaningless or even potentially misleading and should not be disclosed at all in the financial report (Par. 80).

. . . Although both sides make strong arguments, no empirical evidence has been offered that would prove one side right and the other wrong. The Board believes the best approach to resolve this issue is for the closed group data to be reported off the balance sheet as a part of a balanced RSSI package of disclosures about the Social Security and other social insurance programs (Par. 81).

The Board believes that a more complete picture of the financial condition of the government can be provided by a forward-looking assessment of whether it can 'sustain public service and meet obligations as they come due' (Par. 85). . . .

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55. Mr. Anania believes the key issues debated by the Board prior to the issuance of SFFAS 17 remain significant and unresolved. He believes the Board should reconsider the technical aspects of the Social Insurance programs from an accounting and reporting perspective before making the change that is called for by this Statement. He cites the following issues as some, but not all, of the issues the Board should deliberate while keeping the original SFFAS 17 requirements in place: (1) whether the distinction between exchange and non-exchange transactions in the Board's concepts is relevant to a liability recognition, (2) whether the closed group (current participants) population is the most meaningful focus for either recording a liability or for disclosure, and (3) whether the notions of a constructive liability or an "in substance" plan concept require consideration.
56. Further, he is concerned that not enough consideration and debate in connection with the issuance of this Statement was focused on the uncertainty inherent in the open group population (current and future participants) actuarial present values required by Par. 27 (3) (c), (f) and (g). While he acknowledges that the use of assumptions and estimates is accepted in the recording and/or disclosure of financial information, he has serious reservations as to whether the open group actuarial projections that include estimates for future participants in the plans can meet the reliability test. Those projections include receipts and outlays for people expected to be born or immigrate to the U.S. during the projection period (currently 75 years), as well as individuals under 15 years of age at the time of the projection. He believes it is imperative that this issue be fully considered before the Statement of Social Insurance (SOSI) is reclassified as a basic financial statement.
57. Mr. Anania also points out that audit coverage of the SOSI and other information required by SFFAS 17 has been discussed with members of the American Institute of Certified Public Accountants (AICPA) FASAB Liaison Taskforce and Social Insurance Taskforce. To date, there is no clear indication from the AICPA as to the nature of the audit coverage and audit report that would be forthcoming from the independent accountants engaged to audit the Social Security Administration (SSA) financial statements, including the SOSI information. He believes there is a direct correlation and linkage between the reliability of measurement for recognition purposes and the independent auditor's ability to render a meaningful report on those elements in financial statements. The links include the use of

relevant empirical data, reasonability of and support for assumptions used, and the extent to which the information used can be objectively verified. The reliability of the projection methodology should be further explored before the results of those calculations are made an integral part of the basic financial statements.

58. The open group projection that is used to estimate the future financing shortfall in Social Insurance programs is inherently more sensitive to assumptions about the distant future than is true for the closed group calculations that are used to account for employee pensions and retiree healthcare costs. This is inevitably true, despite the best efforts of actuaries, economists, and other professionals involved in making these projections. This is mainly caused by the fact that a closed group dwindles over time, so that uncertainty about what will happen in the distant future has less impact than is the case for an open group that grows larger during the projection period. Currently, the SOSI is presented in the SSA financial report and in the Consolidated Financial Report of the United States Government (CFR) based on 75-year projections under the intermediate assumptions (sometimes referred to as the “best estimate”) of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (generally referred to as Social Security) and corresponding assumptions of the other Social Insurance programs for which the SOSI is required.
59. Mr. Anania observes that FASB Statement of Financial Accounting Concepts No. 7 provides a distinction between estimated cash flows and expected cash flows. The latter refers to the sum of probability-weighted amounts in a range of possible estimated amounts; the estimated mean or average. It is believed by some, including Mr. Anania, that a probability-based approach is a more effective measurement tool in many situations. SSA is currently experimenting with methods that might better incorporate and communicate probabilities and uncertainties, as has been recommended by its technical review panels.⁸ Mr. Anania believes that FASAB should study this further in consultation with others, including actuaries from SSA and the Centers for Medicare and Medicaid Services, before elevating the SOSI as currently defined to the status of a basic financial statement. Mr. Anania believes that the open-group projections that are the basis of the SOSI are more sensitive to assumptions about uncertain future events than is true for most, if not all, long-term

liabilities and basic financial statement disclosures in both private and governmental financial reporting today.

60. Mr. Anania believes there is a further, significant issue that requires consideration before the SOSI is reclassified as a basic statement. The concept is articulation of the elements of the required financial statements. Articulation refers to the linkage of an item in one financial statement to an item reported on a different financial statement. Articulation demonstrates the interrelationships of the various financial statements. That linkage is demonstrated in Appendix 1- A thru 1- F of SFFAC 2, *Entity and Display*. The concept of linkage (described therein as "the order and flow of Data in the financial statements") is also very clearly depicted in a chart on page 43 of the 2001 *Consolidated Financial Report of the United States Government* (CFR). Since the other statements outlined in SFFAC 2 are prepared on an accrual basis, there is no linkage (articulation), as traditionally understood, between the basic financial statements described in SFFAC 2 and the SOSI. While that condition may be tolerable in a compromise standard that requires disclosure as Required Supplementary Stewardship Information (RSSI), Mr. Anania

⁸ For example, the report of the 1999 Technical Panel includes the following observations (available at http://www.ssab.gov/Rpt99_III.html#pgfid-1005309) under the heading, "Illustrating Uncertainty":

"The current system of presenting low- and high-cost alternatives to the intermediate assumptions is inadequate. The alternatives are useful in demonstrating the sensitivity of the forecast to the underlying parameters (section II.G of the Trustees Report). However, without any model of the probabilities of the underlying parameters taking on the alternative values, there is no way to use the alternatives to form a distribution of possible outcomes. It is inadequate to show any forecast without an indication of the uncertainty that surrounds it. We follow previous panels in strongly recommending efforts toward stochastic modeling or similar techniques that are better able to capture the interrelationship among assumptions. We are not dogmatic in the recommendation, as we recognize that even stochastic modeling requires some set of assumptions about the variance in future outcomes—for example in fertility rates—that are hard to estimate. However, the assumptions are in some way embedded in current methods of projection in any case.

"Some modeling techniques allow for graphical presentations that are better at displaying the range of uncertainty. What we seek is a method of displaying to policy makers and the public just how uncertain is some average cost outcome or date of exhaustion of the Trust Funds, and what are the probabilities that events will be close to or far from that result. That the system might have a very high probability of being out of balance by 2 or more percent of taxable payroll, for instance, may be worth knowing regardless of whether it has attained actuarial balance under some set of intermediate assumptions."

does not believe that condition is technically sound or tolerable in basic financial statements.

61. Finally, Mr. Anania does not believe the users of the SSA and CFR financial reports, particularly citizens and citizen intermediaries, will be better served by the change required by this Statement. He is concerned that the lack of linkage to the other basic statements will not be easily understood by users willing to study the information with reasonable diligence. Elevating the SOSI information to become a basic financial statement without accruing a liability or recognizing an expense based on that information might increase confusion of users of Government reports.
62. Mr. Anania does not dissent to Par. 4 of this statement in which the information about Risk Assumed is reclassified from RSSI to required supplementary information (RSI) or to Par. 5, which rescinds the current requirements for the Current Services Assessment.
63. Mr. Kull will abstain from voting on this statement. He will not dissent, as he believes that social insurance information should be included in the basic financial statements and notes and should be subject to audit. However, he shares Mr. Anania's concerns, and further believes these and other concerns need to be resolved before full implementation takes effect, including the development of appropriate audit standards, and the need for items in the financial statements to be grounded in appropriate definitions of the elements of financial reporting. His abstention from voting is intended as an expression of his assessment that the Board has not completed work on this matter.

Statement of Federal Financial Accounting Standards 26: Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25

Status

Issued	October 29, 2004
Effective Date	For periods beginning after September 30, 2008
Volume II References	Social Security (S40)
Interpretations and Technical Releases	None.
Affects	• SFFAS 25, par. 6.
Affected by	• SFFAS 28 amended the effective date presented in par. 6.

Summary

This standard amends Statement of Federal Financial Accounting Standards 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, to require disclosure of significant assumptions underlying the Statement of Social Insurance (SOSI). “Disclosure” means “reporting information in notes or narrative regarded as an integral part of the basic financial statements.” Thus, this amendment reclassifies significant assumptions as basic information rather than as required supplementary information (RSI).

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Introduction

1. In July of 2003, the Board issued SFFAS 25, Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment, and included changes addressing many of the issues identified in responses to the exposure draft (ED) preceding it. One change to the proposal in the exposure draft preceding SFFAS 25 shifted information other than the SOSI from disclosure to RSI status “Disclosure” means “reporting information in notes or narrative regarded as an integral part of the basic financial statements.”¹ RSI is not part of the basic financial statements and is customarily presented as a separate section accompanying the financial statements. Another change to the proposal in the exposure draft preceding SFFAS 25 delayed the effective date to permit the development of audit guidance.

2. The task force of the American Institute of CPAs (AICPA) charged with developing that audit guidance takes exception to the fact that SFFAS 25 permits the preparer to present the significant assumptions underlying SOSI, a basic financial statement, as RSI.² The task force concluded that disclosure related to SOSI would be inadequate if management elects not to disclose significant assumptions in the notes to the financial statements. The task force believes that inadequate disclosure should result in a qualification of the audit opinion. The task force has proposed audit guidance that would require a qualification in the event significant assumptions are not disclosed.

3. The Board believes that generally accepted accounting principles (GAAP) should be clear with respect to adequate disclosure. In this instance, the Board agrees that disclosure of the significant assumptions underlying the SOSI is necessary to an understanding of the SOSI and through this statement amends SFFAS 25.

¹In accounting literature “disclosures” also may be referred to as “notes” or “footnotes.” This statement presents excerpts from other documents with these terms. There is no difference in meaning - rather different authors used different terms with the same meaning.

²SFFAS 25 affords management the option of disclosing the significant assumptions. Par. 6 of SFFAS 25 provides that “Other information required by SFFAS 17 shall be presented as RSI, **except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.**” (Emphasis added.)

Standards

Amendment of SFFAS 25 4. Paragraph 6 of SFFAS 25 is rescinded.

5. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as required supplementary stewardship information (RSSI). The underlying significant assumptions shall be included in notes that are presented as an integral part of the basic financial statement. Other information required by SFFAS 17-- including the sensitivity analysis required in par. 27(4) and 32(4)-- shall be presented as required supplementary information, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.

Effective Date 6. This standard is effective for periods beginning after September 30, 2005.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this proposed statement—not the material in this appendix—would govern the accounting for specific transactions, events or conditions.

7. The Board issued this standard to ensure that significant assumptions are presented as note disclosures to the Statement of Social Insurance so that well established expectations regarding adequate disclosure would be met. Concepts statements from many standard setters explain the requirement for adequate disclosure as follows:

- a. Financial reporting should include explanations and interpretations to help users understand financial information provided. ... Moreover, financial reporting often provides information that depends on, or is affected by, management's estimates and judgment. Investors, creditors, and others are aided in evaluating estimates and judgmental information by explanations of underlying assumptions or methods used, including disclosure of significant uncertainties about principal underlying assumptions or estimates. Financial reporting may, of course, provide information in addition to that specified by financial accounting standards, regulatory rules, or custom. (Financial Accounting Standards Board, CON 1, Objectives of Financial Reporting by Business Enterprises, par. 54)

- b. Information disclosed in notes or parenthetically on the face of financial statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements.⁴ That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles. [4For example, notes provide essential descriptive information for long-term obligations, including what amounts are due, what interest they bear, and whether important restrictions are imposed by related covenants. For inventory, notes provide information on the measurement method used—FIFO cost, LIFO cost, current market value, etc. For an estimated litigation liability, an extended discussion of the circumstances, counsel's

opinions, and the basis for management's judgments may all be provided in the notes. For sales, useful information about revenue recognition policies may appear only in the notes. (FASB Statement No. 47, Disclosure of Long-term Obligations; ARB No. 43, Chapter 4 - Inventory Pricing, Statement 8; FASB Statement No. 5, Accounting for Contingencies, par. 10; and APB Statement 4, par.199)] (CON 5, Recognition and Measurement in Financial Statements of Business Enterprises, par. 7a)

c. Financial information is also conveyed with accompanying footnotes, which are an integral part of the financial statements. Footnotes typically provide additional disclosures that are necessary to make the financial statements more informative and not misleading. (FASAB, SFFAC 2, Entity and Display, par. 68)

d. Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading. Reliability does not imply precision or certainty. Reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured; financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances some financial information is based on reasonable estimates. A properly explained estimate provides more meaningful information than no estimate at all. (Governmental Accounting Standards Board, Concept Statement 1, par. 64)

8. The Board believes that the underlying significant assumptions are essential to fair presentation. The Board believes that generally accepted accounting principles should result in disclosure of the significant assumptions upon which SOSI is based. Disclosures are an integral part of the basic financial statements while RSI is not an integral part of the basic financial statements. RSI accompanies the basic financial statements. Placing the significant assumptions in the disclosures associated with the SOSI serves two purposes. First, the significant assumptions inform the reader about the basis for the projections presented in the SOSI. Second, the reader has ready access

to the significant assumptions through association with a principal financial statement.

9. The Board received 8 responses to its March 12, 2004 exposure draft on this subject. Of the responses, 5 were from federal respondents and 3 were from non-federal respondents. Seven of the eight respondents supported the proposal. However, two supported the proposal contingent on suggested changes.
10. One recommended that the Board also include in the note disclosure an explanation of the uncertainty inherent in the process. The recommendation is not without merit but cannot be adopted absent an exposure draft proposing the change. The Board is not actively pursuing this additional amendment to SFFAS 25. The Board believes the nature of the information is adequately explained by the:
 - a. required summary of significant accounting policies,
 - b. disclosure of the significant assumptions,
 - c. language in the auditor's report on SOSI explaining that there will be differences between the forecasts and actual results, and
 - d. presentation of the sensitivity analysis as required supplementary information.
11. Another respondent requested that the Board defer the effective date of this amendment and SFFAS 25. Occasionally, the Board has deviated from the proposed effective date when finalizing standards proposed in an exposure draft and this is not considered a deviation significant enough to warrant re-exposure of the proposal. However, to alter the effective date of a previously issued standard - in this case SFFAS 25 - due process requires that the Board seek input on that change through an exposure draft proposing such a change. One example of this is the deferral of SFFAS 4, Managerial Cost Accounting Standards for the Federal Government.
12. Since the Board is unable to alter the effective date of SFFAS 25 through this amendment, the Board is proceeding with the earlier effective date for this amendment to ensure consistency with SFFAS 25. The Board is considering the request for deferral of SFFAS 25. An exposure draft was issued on July 20, 2004 proposing a one-year

deferral of both SFFAS 25 and this standard. The Board will consider comments on the exposure draft and may issue a statement amending the effective dates.

Board Approval

13. This statement was approved for issuance by all members of the Board.

**Appendix B:
Abbreviations**

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial

Statement of Federal Financial Accounting Standards 27: Identifying and Reporting Earmarked Funds

Status

Issued	December 28, 2004
Effective Date	For periods beginning after September 30, 2005
Volume II References	Consolidated Financial Report of the US Government (C60), Earmarked Funds (E10), Investments in Treasury Securities (I80), Revenue (R40)
Interpretations and Technical Releases	None.
Affects	<ul style="list-style-type: none">• SFFAS 7• SFFAC 2• SFFAC 3
Affected by	None.

Summary

This statement defines and addresses “earmarked funds.” Note that this statement uses the term “earmarked” only as it is defined below. This statement does not use the term “earmarked” as it is sometimes used to refer to set-asides of appropriations for specific purposes.

Scope of this Statement

The Board’s proposed standard for "Fiduciary Activities" and this standard on “Earmarked Funds” together address all activities or funds considered “dedicated collections” by Statement of Federal Financial Accounting Standards (SFFAS) 7. When finalized, the fiduciary activities standard will rescind the “dedicated collections” provisions in SFFAS 7. This standard supersedes the “dedicated collections” provisions in SFFAS 7 (paragraphs 83-87) for earmarked funds.

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government’s general revenues. The three required criteria for an earmarked fund are:

1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and

-
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

An earmarked fund may be classified in the unified budget as a trust, special, or public enterprise fund. Application of this standard, however, should not be based on whether a statute or the unified budget labels an earmarked fund as a certain type of fund. Rather, the Board intends that the term earmarked fund be applied based on the substance of the statute and consistent with the three criteria set forth in the standard.

Reporting Requirements

The component entity will show earmarked nonexchange revenue and other financing sources, including appropriations, and net cost of operations separately on the Statement of Changes in Net Position. The component entity also will show the portion of cumulative results of operations attributable to earmarked funds on the Statement of Changes in Net Position and on the Balance Sheet.

At the Government-wide level, earmarked revenue, other financing sources and net cost of operations will be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The U.S. Government Balance Sheet will show separately the portion of net position attributable to earmarked funds.

This standard requires that every component entity disclose the earmarked fund(s) for which it has program management responsibility. It also requires condensed information on assets, liabilities and cost for all earmarked funds, although it permits information on funds not presented individually to be aggregated. In addition, it requires disclosure of any legislation that changed the purpose of or redirected a significant portion of an earmarked fund.

Required note disclosures at the component entity level will clarify the fact that investments in Treasury securities held by the component entity are not assets for the Government as a whole. That is, the investments in Treasury securities are available for authorized expenditures and are thus assets of the managing component entity. However, financing will be needed by the Government as a whole when those investments in Treasury securities are redeemed to make expenditures.

In addition, this standard addresses those situations where several component entities each have program management responsibility for separate, identifiable portions of the earmarked fund. By requiring each component entity to report on only its portion of the earmarked fund, the standard assists report users in evaluating the service efforts, costs and accomplishments of the component entity.

Effective Date

The provisions of this standard are effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

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Introduction

1. This statement defines and addresses “**earmarked funds**.”¹ Note that this statement uses the term “earmarked” only as it is defined below. This statement does not use the term “earmarked” as it is sometimes used to refer to set-asides of appropriations for specific purposes.
2. This statement amends Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources*. This statement defines and addresses earmarked funds and differentiates between earmarked funds and **fiduciary activity**. This statement requires that earmarked funds be identified and shown separately on the Statement of Changes in Net Position (for U.S. Government-wide, the Statement of Operations and Changes in Net Position) and the Balance Sheet. It also requires the component entity to identify all earmarked funds for which it has management responsibility, by either a list by official title or a statement indicating where the information can be obtained and to provide specific information on earmarked funds including revenue sources, assets and liabilities, and changes in net position.
3. Earmarked revenue and other financing sources are accounted for in earmarked funds with widely disparate characteristics. In a 2001 report, the Government Accountability Office (GAO) identified three hundred and ninety-two possible earmarked funds². Annual revenues and other financing sources for those earmarked funds range from negligible amounts to over half a trillion dollars. Accumulated balances range from zero to over a trillion dollars.
4. Earmarked funds are financed by specifically identified revenues and other financing sources (such as appropriations) and serve a variety of purposes. Revenue sources may be exchange or nonexchange and include but are not limited to payroll taxes, excise taxes, customs duties, fees, user charges, sales of goods and services and interest earned. In addition, although earmarked funds are usually the

¹ Words first appearing in **boldface** are defined in Appendix B: Glossary.

² GAO, *Federal Trust and Other Earmarked Funds*, January 2001, GAO-01-199SP, p. 12. The term “earmarked funds” used by GAO in its survey differs from that established by this standard and was not intended to reflect standards for financial reporting. The term “earmarked funds” as used in either the GAO report or other governmental issuances shall not govern the application of this standard.

responsibility of a single entity, management responsibility for some earmarked funds is shared by two or more entities.

5. The purpose of earmarked funds ranges from the long-term commitments financed by social insurance taxes, such as Social Security, to business-type activities financed mainly by exchange transactions, such as the Employees Life Insurance Fund. Every department and many independent agencies have at least one earmarked fund. Therefore, earmarked funds affect a wide array of programs, including commerce, income security, natural resources, administration of justice, agriculture, education, science and technology, the environment, healthcare, housing credit and insurance.
6. Despite the differences among earmarked funds they do share certain characteristics. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time, are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the government's general revenues.
7. The following chart shows fund types used in reporting to the Treasury Financial Management Service (FMS) and the Office of Management and Budget (OMB). It is intended only to show the general relationship between fund groups and earmarked funds as classified in this statement. Regardless of classification for reporting to the Treasury FMS or the OMB, funds meeting the definition of earmarked funds promulgated in this standard should be so classified and funds not meeting the definition should not be so classified.

Table 1. Fund Groups Used in Federal Reporting to the Treasury FMS and the OMB

Fund Groups and Major Classes	Generally Are Subject to the Reporting Requirements of this Standard	Generally Are Not Subject to the Reporting Requirements of this Standard
General Funds0000-3999		X
Revolving Funds.....4000-4999		
Intra-governmental Revolving Funds		X
Public Enterprise Funds:		
Credit Reform Financing Funds		X
All Other Public Enterprise Funds	X	
Special Funds 5000-5999	X	
Deposit Funds6000-6999		X
Trust Funds8000-8999	X	

8. Funds that receive earmarked revenue and other financing sources include special funds, trust funds -- both revolving and non-revolving -- and public enterprise funds. The **general fund** is used to carry out the general purposes of Government rather than being restricted by law to a specific program. It consists of all collections not earmarked by law to finance other funds, including virtually all income taxes and many excise taxes, and all expenditures financed by these collections and by general U.S. Treasury borrowing.³ While **intragovernmental funds**, which are revolving funds that conduct business-type operations primarily within and between Government agencies, share the characteristics of an earmarked fund, they are excluded from the reporting requirements of this standard. Credit financing accounts and fiduciary funds are also excluded.

³ Analytical Perspectives, Budget of the United States Government, Fiscal Year 2005, p. 339.

Scope

9. This statement provides accounting and reporting standards for earmarked funds in the general purpose financial statements of reporting entities and the U.S. Government-wide Financial Report. This statement does not affect reporting in the *Budget of the United States Government* or any other special purpose type of report.

Effective Date

10. This statement is effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

Accounting Standards

Definition of Earmarked Funds

11. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. The three required criteria for an earmarked fund are:
 1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
 2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
 3. A requirement to account for and report⁴ on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.
12. The requirement to account for revenues and other financing sources that are statutorily available only for designated activities, benefits or purposes is usually created by statute. An earmarked fund may be classified in the statute, the unified budget, or both, as a trust, special, or public enterprise fund. Application of this standard, however, shall not be based on how a statute or the unified budget labels the fund. Rather, the Board intends that the term "earmarked fund" be applied based on the substance of the statute and consistent with the three criteria described above.
13. **Fund** in this statement's definition of earmarked funds refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related

⁴ A "report" may be something other than stand-alone financial statements for the earmarked fund.

liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.”⁵

Distinct from the General Fund

14. Whereas earmarked funds are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not earmarked by law for a specific purpose and the proceeds of general borrowing. Although there are exceptions, funding decisions regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing earmarked funds reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Earmarked funds may have a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the appropriation is provided by authorizing legislation or annual appropriations acts, the cumulative results of operations arising from earmarked funds is reserved or restricted to the designated activity, benefit or purpose.

Distinct from Fiduciary Activities

15. The activity of earmarked funds differs from fiduciary activities primarily in that earmarked fund assets are Government-owned. A fiduciary activity is the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold⁶. Therefore, even though an earmarked fund is designated exclusively for a specific activity, benefit or purpose, the Federal Government does not have a fiduciary relationship with the individuals or groups who potentially will benefit from the fund.

⁵ National Council on Governmental Accounting Statement 1, par. 16.

⁶ See the FASAB exposure draft of March 2003, *Accounting for Fiduciary Activities*, for more on fiduciary activity in the Federal Government and the differences between private trust funds and Federal government trust funds.

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| Distinct from Private Sector Trust Funds | <p>16. Although earmarked monies are predominantly in funds that are designated by law as trust funds, the meaning of the term “trust” in the Federal Government differs significantly from its meaning in the private sector. Whereas earmarked funds in the Federal Government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship.</p> <p>17. An earmarked fund should not be characterized as a “trust” in general purpose external financial reports of Federal entities. (The use of the term “trust fund” is acceptable only in the fund’s official title.)</p> |
| Exclusions from Reporting Requirements | <p>18. Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds are excluded because they are revolving funds that conduct business primarily within and between Government agencies. Credit financing accounts are also excluded. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to Federal credit programs. Fiduciary funds, which are not Government-owned, are also excluded.</p> |
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Reporting for Earmarked Funds

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation

19. Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position. Also, the portion of cumulative results of operations attributable to earmarked funds should be shown separately on both the Statement of Changes in Net Position and the Balance Sheet. This standard does not require earmarked funds to be separately shown on the Statement of Net Cost. (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)
20. Most earmarked revenues and other financing sources are in the basic financial statements of the entity carrying out the program and responsible for administration of the fund. If more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the

separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.⁷

Disclosure

21. A component entity should disclose⁸ all earmarked funds for which it has program management responsibility by either a list, by official title, or a statement indicating where the information can be obtained. An earmarked fund should not be characterized as a “trust” in general purpose external financial reports of Federal entities. (The use of the term “trust fund” is acceptable only in the fund’s official title.)
22. The following information should be disclosed for individual earmarked funds. An exception is provided for component entities having numerous individual earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual earmarked funds and in aggregate for all remaining earmarked funds:
 1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.
 2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

The information required by this paragraph for earmarked funds may be presented separately on the face of the entity's basic financial

⁷ To determine program management/accounting responsibility, agencies should consider the legislation authorizing the program; the Memorandum of Understanding that establishes responsibilities; and the provisions of SFFAC 2, *Entity and Display*, as amended by this standard.

⁸ Disclosure is reporting information in notes or narrative regarded as an integral part of the basic financial statements.

statements or disclosed in the accompanying notes. Information for funds not presented individually may be aggregated, but must be provided even if the aggregate total is immaterial. The total cumulative results of operations shown in the note disclosure should agree with the cumulative results of operations for earmarked funds shown on the face of the component entity's basic financial statements.⁹ (See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)

23. The following information should be disclosed for each individually reported earmarked fund, or portion thereof, for which a component entity has program management responsibility (see paragraph 24.).
 1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.
 2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.
 3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.
24. Selecting earmarked funds to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's earmarked revenues or cumulative results of operations from earmarked funds; and qualitative factors such as whether an earmarked fund is of immediate concern to constituents of the fund, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the financial statements would be the primary source of financial information for the public.

⁹ For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.

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25. The total cumulative results of operations of all earmarked funds shown in the note disclosure should agree with the cumulative results of operations of earmarked funds shown on the face of the component entity's Balance Sheet and the Statement of Changes in Net Position.
26. In accordance with the provisions of paragraph, if a component entity reports a different portion of an earmarked fund than it reported in prior years, it should not restate its prior year financial statements. It should disclose the change in a note. This applies if a component entity does not report an earmarked fund, or portion thereof, that it reported in the previous year. It also applies if a component entity does report an earmarked fund, or portion thereof, that it did not report in the previous year.

Note on Investments

27. Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:
- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general Government purposes.
 - Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).
 - Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.
 - When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.
28. Below is one example of a note that addresses the points in paragraph 27.

Intra-governmental Investments in Treasury Securities

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (or

name/s of fund/s). The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the (component entity) as evidence of its receipts. Treasury securities are an asset to the (component entity) and a liability to the U.S. Treasury. Because the (component entity) and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the (component entity) with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the (component entity) requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Financial Statement
Presentation and
Disclosures for the U.S.
Government-wide Financial
Statements

Financial Statement Presentation

29. Earmarked funds should be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The portion of Net Position attributable to earmarked funds should be shown separately on the U.S. Government Balance Sheet.¹⁰ (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)

Disclosure

30. Specific information should be disclosed for selected earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual earmarked funds and in aggregate for all remaining earmarked funds with

¹⁰ Net Position is composed of unexpended appropriations and cumulative results of operations for component entities. Since unexpended appropriations are not applicable at the U. S. Government-wide level, net position equals cumulative results of operations.

eliminations necessary to produce the Government-wide total of earmarked funds:

1. Condensed information about assets, liabilities and net position.
 2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.
31. The information for earmarked funds should be disclosed in the notes accompanying the basic financial statements. Information for funds not shown individually may be aggregated (see paragraph 24). A total column should be presented that relates the disaggregated data to the data on the face of the principal financial statements. The net position shown in the note disclosure should agree with the portion of net position attributable to earmarked funds shown on the face of the balance sheet.
32. A note disclosure should provide a reference to component reports for additional information about individual earmarked funds.
33. A note disclosure should provide a general description of earmarked funds and an explanation of how the Federal Government as a whole could provide the resources represented by the earmarked funds' balance in Treasury securities.
34. An earmarked fund should not be characterized as a "trust" in general purpose external financial reports of Federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Basis of Accounting

35. All amounts reported and disclosed in the reporting entity's basic financial statements or the notes thereto, as required in paragraphs 19 through 34, should be recognized and measured using the standards provided in generally accepted accounting principles applicable to the Federal Government.

Effective Date and Implementation

36. This standard is effective for periods beginning after September 30, 2005. Early adoption is not permitted. In the year this standard becomes effective, entities should not restate the prior period columns of the basic financial statements and related disclosures.

Effect on Existing Standards

37. This standard affects existing standards dealing with “dedicated collections” in Statement of Federal Financial Accounting Standards 7, *Revenue and Other Financing Sources*, as follows: for funds meeting the definition of earmarked funds promulgated in this standard, paragraphs 83 through 87 are replaced by this standard.

38. This standard amends Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display* footnote 3, as follows:

For some trust funds, the collection of the revenues is performed by an organizational entity acting in a custodial capacity that differs from the organizational entity that administers the trust fund. In those instances, the organizational entity that collects the revenue would be responsible for reporting only the collection and subsequent disposition of the funds. The organizational entity responsible for carrying out the program(s) financed by a trust fund, ~~or in the case of multiple responsible entities, the entity with the preponderance of fund activity,~~ will report all assets, liabilities, revenues and expenses of the fund, notwithstanding the fact that another entity has custodial responsibility for the assets. In the case of multiple responsible entities, if the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of SFFAS 27, *Identifying and Reporting Earmarked Funds*. If separate portions cannot be identified, the component entity with program management responsibility should report the fund.

39. This standard amends SFFAC 3, Management’s Discussion and Analysis- Concepts, paragraph 26 as follows:

Financial Results, Position and Condition-MD&A should help those who read it to understand the entity's financial results and financial position and the entity's effect on the financial position and condition of the Government. It should give readers the benefit of management's understanding of the significance and potential effect from both a short- and a long-term perspective of:

- the variations discussed in paragraph 14 in terms of major changes in types or amounts of assets, liabilities, costs, revenues, obligations and outlays;
- particular balances and amounts shown in the basic financial statements, including the notes, such as those dealing with

-
- ~~dedicated collections or trust funds~~ earmarked funds, if relevant to important financial management issues and concerns; and the entity's required supplementary stewardship information (because RSSI describes economic conditions that cannot be expressed in the basic financial statements).

The provisions of this statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement – not the material in this or other appendices – should govern the accounting for specific transactions, events or conditions.

40. FASAB published the exposure draft *Identifying and Reporting Earmarked Funds* on October 16, 2003. Upon release of the exposure draft, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, *Government Accounting and Auditing Update*, and *JFMIP News*; the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past. A public hearing was held on March 4, 2004. Sixteen letters were received from the following sources; three respondents supplemented their written responses with oral testimony at the public hearing.

Comment letters and/or oral testimony provided by:	Federal (Internal)	Non-Federal (External)
Users, academics, others		3
Auditors	1	2
Preparers and financial managers	10	

Response to Comments Received

41. The majority of the respondents concurred with most of the provisions of the proposed standard. Several sources expressed the opinion that all of the disclosures should be placed in the notes to the financial statements. The Board's reasons for requiring some reporting on the face of the financial statements is provided in the section, "Reporting Treatment," which begins at paragraph 59 of this Appendix.

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42. Several respondents requested guidance regarding criteria to consider in selecting earmarked funds for disaggregated disclosure; additional guidance has been included in this standard.
 43. Several respondents questioned the term, “accounting mechanism,” and asked why this term was used instead of a more specific term, such as Treasury account fund symbol. This standard eliminates references to accounting mechanisms and states that the Board’s intent is to establish a principle-based standard that is not dependent upon funding terminology that is subject to change.
 44. Two respondents requested that the examples in Appendix C differentiate between the Treasury General Fund and the Treasury Bureau of Public Debt. The examples in Appendix C now include that distinction.
 45. Two respondents asked for more detail regarding mixed-activity funds and the word “primarily.” However, the Board considers the definition criteria and the term “primarily” to be sufficiently clear regarding the classification of mixed-activity funds
 46. One respondent identified credit financing accounts as a category of funds that would be covered by the standard, based upon definition criteria, that should not be included. Credit financing accounts are nonbudgetary funds that do not accumulate results of operations; they primarily serve as clearing accounts for cash activity relating to Federal credit programs. The standard includes an “Exclusions” paragraph (paragraph 18) which excludes credit financing accounts from the reporting requirements of this standard.
 47. Three respondents had questions about earmarked funds that have exchange revenue. Appendix C has been expanded to include both exchange and nonexchange revenue.
 48. Two respondents had questions about the reporting requirements for earmarked funds managed by multiple agencies. Footnote 7, which provides factors to consider in determining program management, has been added. Paragraph 38, which amends SFFAC 2, “Entity and Display,” has also been added.

**Existing Accounting
Standard Needs
Clarification**

49. The objective of this standard is to define earmarked funds and provide accounting and reporting guidance for them. In the existing standard, SFFAS 7, *Revenue and Other Financing Sources*, paragraphs 83 through 87, the term “dedicated collections” includes revenue earmarked or dedicated to finance or help finance specific Federal programs as well as revenue being held for the exclusive benefit of specific, identifiable non-Federal parties.¹¹
50. SFFAS 7 did not differentiate between (a) Government-owned revenue and other financing sources earmarked to finance or help finance specific Federal programs (earmarked funds) and (b) cash and other assets being held for the exclusive benefit of specific, identifiable non-Federal parties who have ownership interest in the assets (fiduciary activities). The Board believes separate standards based on the unique characteristics of these two types of “dedicated collections” are needed. In April 2003 the Board issued an exposure draft of a proposed standard, *Accounting for Fiduciary Activities*, to address those activities relating to the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.
51. The Board's proposed standard for "Fiduciary Activities" and this standard on "Earmarked Funds" together address all activities or funds considered "dedicated collections" by SFFAS 7. When finalized, the fiduciary activities standard will rescind the "dedicated collections" provisions in SFFAS 7. This standard supersedes the “dedicated collections” provisions in SFFAS 7 (paragraphs 83-87) for earmarked funds.
52. SFFAS 7 classifies funds as “dedicated collections” based on the term “trust” as used in the U.S. Government Budget. It states that the standard covered “all funds within the budget classified as trust funds,” and “those funds within the budget that are classified as "special funds" but that are similar in nature to trust funds.”¹² The Board found this definition was insufficiently precise to ensure that all

¹¹ SFFAS 7, par. 83.

¹² Ibid.

earmarked funds were reported as intended. The definition in this standard provides a substantive basis for classifying funds instead of relying on terms used in the budget.¹³

Special Accountability

53. Although the Federal Government does not have a fiduciary relationship (as defined by the proposed standard, *Accounting for Fiduciary Activities*¹⁴) with the potential beneficiaries of earmarked funds, the unique nature of earmarked funds necessitates additional explanation and disclosure in the basic financial statements. In SFFAS 7, *Accounting for Revenue and Other Financing Sources*, special accountability reporting provisions were applied to all “dedicated collections” regardless of whether or not they involved Government-owned funds or private funds. The concept of special accountability applies to earmarked funds.
54. All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose. There is often a direct link between the source of fund revenues and designated activities, benefits or purposes in an effort to charge beneficiaries or users for benefits received. Resource inflow is accounted for separately from general tax receipts, allowing the program’s status to be more easily examined. Many earmarked funds receive permanent appropriations in an amount equal to these inflows that become available without recurrent action by Congress through annual appropriations.
55. Earmarked funds are of interest to a universe of contributors, taxpayers and recipients, who have an expectation that earmarked revenues will be used for the purposes specified in the law authorizing the collection of the revenues. For example, current contributors to

¹³ The exposure draft, *Accounting for Fiduciary Activities*, discusses the differences between private trust funds, Federal government trust funds designated as trusts by Congress, and fiduciary funds.

¹⁴ The exposure draft, *Accounting for Fiduciary Activities*, was issued in March 2003.

Social Security programs may assume that their earmarked taxes in excess of payments to current recipients will be available to fund future social security benefits. The likelihood of the public making this assumption may reasonably be expected when the Federal Government issues projections of the availability of accumulated balances for future payments.

Identifying Earmarked Funds

56. The Board considered whether any substantive difference exists between earmarked funds that are designated as “trusts” and those that are not. It also considered whether any substantive difference exists between earmarked funds that conduct business-type operations and those that do not. The Board did not find a substantive difference in either case. Therefore, all earmarked funds that meet the special accountability criteria in paragraph 11 of the standard are subject to the provisions of the standard, regardless of whether they are labeled as “trusts” or not and regardless of whether they conduct business-type operations or not.
57. The Board also considered whether intragovernmental funds should be included in the reporting requirements for earmarked funds. Although intragovernmental funds may meet the criteria of the definition of an earmarked fund, the Board does not believe intragovernmental funds warrant special accountability to the public because these funds conduct business-type operations primarily within and between Government agencies. Intragovernmental balances are eliminated in the consolidation process in the preparation of the U.S. Government-wide financial statements.
58. The Board also decided to exclude credit financing accounts from the reporting requirements for earmarked funds. Although credit financing accounts may meet the criteria of the definition for earmarked funds, they primarily serve as clearing accounts for cash activity relating to Federal credit programs and do not accumulate results of operations. Fiduciary funds, which are not Government-owned, are also excluded.

Reporting Treatment

Effect on Net Position

59. Special accountability for earmarked funds is of increasing importance because the amount of revenue directed to earmarked funds has increased dramatically over the past two decades. It now constitutes a much greater proportion of the Federal budget. Just those earmarked funds designated as “Federal trust funds” by Congress alone accounted for over fifty percent of receipts from the public in 2003.
60. In addition, the invested balances of earmarked funds have grown significantly over the past two decades. Debt held by Government accounts was approximately \$2.85 trillion in 2003, a twelve-fold increase from 1983¹⁵.
61. Most of these balances are invested in Treasury securities. The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general government purposes. Treasury securities are issued to the earmarked fund as evidence of its receipts. Treasury securities are an asset to the component entity and a liability to the U.S. Treasury. Because the component entity and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.
62. Treasury securities provide the component entity with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the component entity requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures. The investments in Treasury securities (an asset) held by the various earmarked funds and

¹⁵ Fiscal Year 2005 Historical Tables, Budget of the U.S. Government, pp. 118-119.

the liability of the U.S. Treasury to redeem the securities are treated as intragovernmental eliminations when the consolidated U.S. Government-wide financial statements are prepared. Therefore, the consolidated net position of the Federal Government reported on the U.S. Government-wide financial statements does not include the effect of the claim on the U.S. Treasury that the various funds hold, just as the consolidated net position does not include the effect of other intragovernmental claims. Instead, the U.S. Government-wide financial statements include the cumulative results of operations of earmarked funds – currently a large positive balance – as an offset against the cumulative results of operations of the general fund – currently a large negative balance. The result is that the financing provided by earmarked fund operations to general fund operations – which would otherwise be financed through the issuance of debt to the public, tax increases or other financing sources – is not shown on the face of the U.S. Government Balance Sheet.

63. This standard requires component entities to show the total amount of cumulative results of operations attributable to earmarked funds on the Statement of Changes in Net Position and on the Balance Sheet. The U.S. Government-wide financial statements are subject to the same requirement, except that the U.S. Government-wide financial statements include the U.S. Government Statement of Operations and Changes in Net Position instead of the Statement of Changes in Net Position. Net position at the component level is composed of unexpended appropriations and cumulative results of operations. Since unexpended appropriations are not applicable at the Government-wide level, net position equals cumulative results of operations. Under this standard the financial statements would thus present – in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.
64. This standard also requires that component level financial statements include an explanation of earmarked fund investments in Treasury securities similar to the one given in paragraphs 27 and 28. The U.S. Government-wide financial statements are required to include an explanation of how the Government as a whole could provide the resources represented by the earmarked funds' balance in Treasury securities.

65. Several respondents to the exposure draft recommended that all reporting requirements relating to earmarked funds should be limited to the financial statement notes. Due to the impact of earmarked funds upon the financial position of the U.S. Government as a whole, as discussed in this section, the Board decided that certain basic disclosures, such as the impact upon net position, should appear on the face of the financial statements.

Effect on Flows

66. For component entities, earmarked nonexchange revenue and other financing sources and net cost of operations are required to be shown separately in the Statement of Changes in Net Position. For the U.S. Government-wide financial statements, the components of earmarked funds activity should be shown separately on the U.S. Government Statement of Operations and Changes in Net Position. The Board believes that it is equally as important to show the earmarked funds activity during the period as it is to show the cumulative results of operations. Each gives a different and complementary perspective on the proportion of activity financed by general versus earmarked resources: the cumulative results of operations show the effect of all reporting periods up to a single point in time, whereas reporting of the earmarked funds activity shows the inflows and outflows during the reporting period. The relative importance indicated by each measure may differ because of trends in financing or special timing needs.

Disclosure

67. The Board determined that a number of earmarked funds were not being reported as intended under the existing standard. Therefore, in addition to clarifying the definition of earmarked funds, the standard requires that each component provide either a list of all earmarked funds for which it has program management responsibility or a statement as to where the information can be obtained. This requirement would ensure that no earmarked fund is omitted from the financial statements and that users could more easily locate information on a specific earmarked fund and determine its status. This information would not be required at the Government-wide level since program management responsibility does not reside at that level.
68. This standard requires condensed information on selected earmarked funds to be disclosed individually, with aggregate condensed information required for all others. In response to several requests from respondents to the exposure draft, the Board included, in paragraph 24 of this Statement, examples of quantitative and

qualitative factors to be considered in selecting earmarked funds to be presented individually.

69. A component entity is required to disclose any change in legislation that significantly changes the purpose of the fund or that redirects a significant portion of the accumulated balance. In the opinion of the Board, the characteristic of special accountability requires that any significant change in the legislation governing the earmarked fund be disclosed in order to provide greater accountability for the earmarked revenues.

Other Changes

70. If more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the separate portions of the program can be clearly identified with the responsible component entity, then each component entity should report its portion in accordance with this standard. In the existing standard, SFFAS 7, paragraph 87, requires that “If more than one component entity is responsible for carrying out the program financed with the dedicated collections, then the entity with the largest share of the activity should be responsible for reporting all revenues, other financing sources, assets, liabilities, and costs of the fund.¹⁶” The Board believes that this revision will assist users to evaluate the service efforts, costs and accomplishments of the component entity with actual program management responsibility, by relating relevant costs directly to the associated mission and performance.
71. For funds meeting the definition criteria of earmarked funds, paragraph 86 of SFFAS 7 is replaced by this standard. In the opinion of the Board, the necessary guidance is provided in this standard in paragraph 35.

Implementation

72. Early implementation of this standard is not permitted because of the difficulties that might arise when component financial statements are consolidated into the Government-wide financial statements. For example, a problem might arise if a component entity, which had previously reported all of the activity of an earmarked fund based on the requirements of the existing standard, decided upon early

¹⁶ SFFAS 7, Accounting for Revenue and Other Financing Sources.

implementation of the standard, which allows it to report only that portion of the earmarked fund for which it has program management responsibility. This choice would cause portions of the earmarked fund not to be reported in the consolidated financial statements unless the component entities with management responsibility for the other portions of the earmarked fund also chose early implementation of the standard. For the same reason, restatement of the prior period columns in the initial year of implementation is not permitted.

Board Approval

73. This statement was approved for issuance by all members of the Board.

Appendix B:
Glossary

[See consolidated Glossary in Appendix E of this Volume]

**Appendix C: Pro
Forma Illustrations**

Table of Illustrations

Transactions – Component Entity Receives Revenue and Purchases Securities

1.A. Entries recording receipt of earmarked revenue by Component Entity

1.B. Entries recording the Component Entity's purchase of Treasury Securities

1.C. Entries recording interest on Treasury Securities

Pro Forma Statements showing effect on Component Entity's basic financial statement reporting

1.D. (1) Component Entity Statement of Changes in Net Position

1.D. (2) Component Entity Balance Sheet

Pro Forma Statements showing effect on the U.S. Government-wide Financial Statements

1.E. (1) U.S. Government-wide Consolidation Worksheet:

1.E. (2) U.S. Government Statement of Operations and Changes In Net Position

1.E. (3) U.S. Government Balance Sheet

Transactions– Component Entity Receives Revenue and Purchases Securities

1. A. Entries recording receipt of earmarked revenue collected by the Component Entity:

	DR	CR
<u>Component Entity</u>		
Fund Balance with Treasury (FBWT)	1,000	
Nonexchange revenue		600
Exchange revenue ¹⁸		400
To record receipts credited to earmarked fund.		

Treasury General Fund Entity

Treasury General Fund Cash	1,000	
General Fund’s Liability for FBWT		1,000
To record earmarked revenue collected by Component Entity.		

1.B. Entries recording the Component Entity purchase of Treasury securities:

	DR	CR
<u>Component Entity</u>		
Investments in Treasury Securities	1,000	
Fund Balance with Treasury		1,000
To record Treasury securities purchased.		

¹⁸This standard does **not** require exchange revenue for earmarked funds to be separately shown on the Statement of Net Cost

Treasury General Fund Entity

General Fund's Liability for FBWT (Component Entity)	1,000	
General Fund's Liability for FBWT (Treasury BPD)		1,000
To record payment to Treasury Bureau of Public Debt for securities purchased.		

Treasury Bureau of Public Debt Entity

Fund Balance with Treasury	1,000	
Liability for Intragovernmental Debt- Treasury Securities		1,000
To record sale of securities to Component Entity earmarked fund.		

1.C. Entries recording interest earned on Treasury securities**Component Entity**

Fund Balance with Treasury (FBWT)	10	
Interest Revenue- Exchange		4
Interest Revenue- Nonexchange ¹⁹		6
To record interest income on Treasury securities.		

Treasury Bureau of Public Debt Entity

Interest Expense	10	
Fund Balance with Treasury (FBWT)		10
To record interest expense.		

Treasury General Fund Entity

General Fund's Liability for FBWT (Treasury BPD)	10	
General Fund's Liability for FBWT (Component Entity)		10
To record payment of interest to Component Entity by Treasury BPD.		

¹⁹For classification of exchange and nonexchange interest revenue, see SFFAS 7, Appendix B, paragraphs 306-308.

Pro Forma Statements showing effect of illustrative transactions on Component Entity's basic financial statement reporting²⁰

(This is only one example of how the required information could be displayed.)

**1.D. (1) Component Entity
Statement of Changes in Net Position**

	Cumulative Results Of Operations	
	Social Security and Other Earmarked Funds	All Other
Beginning balance of net position	\$ -	\$ -
Budgetary financing sources:		
Non-exchange revenue		606
Net cost of operations [from statement of net cost]	<u>(404)</u>	
Change in net position	<u>1,010</u>	
Ending balance of net position	<u>\$ 1,010</u>	\$ -

**1.D. (2) Component Entity
Balance Sheet**

	Social Security and Other Earmarked Funds	All Other
ASSETS		
Fund balance with Treasury	\$ 10	\$ -
Investments in Treasury securities	<u>1,000</u>	
Total assets	<u>\$ 1,010</u>	
LIABILITIES		
	\$ -	\$ -
NET POSITION		
Unexpended Appropriations	\$ -	\$ -
Cumulative Results of Operations	<u>1,010</u>	
Total Net Position	<u>1,010</u>	
Total liabilities and net position	<u>\$ 1,010</u>	\$ -

²⁰This standard does **not** require earmarked funds to be separately shown on the Statement of Net Cost.

1.E. (1) Consolidation Worksheet for U.S. Government-wide Financial Statements

	Component Entity	Treasury General Fund	Treasury BPD	Eliminations	Gov't-wide
ASSETS					
Treasury General Fund Cash Account	\$ -	\$ 1,000	\$ -	\$ -	\$ 1,000
Fund balance with Treasury	10	-	990	-1,000	-
Investments in Treasury Securities	1,000			-1,000	-
Total assets	\$ 1,010	\$ 1,000	\$ 990	\$ -	\$ 1,000
LIABILITIES					
Treasury General Fund Liability for FBWT	\$ -	\$ 1,000	\$ -	\$ -1,000	-
Treasury BPD Liability for Intragovernmental Debt			1,000	-1,000	-
Total Liabilities	\$ -	\$ 1,000	\$ 1,000	\$ -	\$ -
NET POSITION					
Net Position of Other Funds	-	-	-	-	-
Net Position of Federal Old-Age Survivors Insurance and Other Earmarked Funds	\$ 1,010		\$ -10		\$ 1,000

Pro Forma Statements showing effect of illustrative transactions on U.S. Government-wide financial reporting

1.E. (2) U.S. Government Statement of Operations and Changes in Net Position

Operating Results:

Earmarked Funds Activity

Revenue:

Social Security Tax Revenue	\$ 600
Other Revenue and Other Financing Sources	<u>400</u>
Total revenue	1,000
Less net cost of operations	<u>--</u>
Net operating revenue	1,000

General Activities

Revenue	--
Less net cost of operations	<u>--</u>
Net operating cost	<u>--</u>

Total net operating revenue (cost), all government activities	<u>\$ 1,000</u>
---	-----------------

Net Position:

Net Position, Beginning of Period	
Social Security and Other Earmarked Funds	\$ --
All Other	--
Net Position, End of Period	
Social Security and Other Earmarked Funds	1,000
All Other	<u>--</u>
Total Net Position	<u>\$ 1,000</u>

1.E. (3) U.S. Government Balance Sheet

ASSETS	
Treasury Government-wide Cash Account	\$ 1,000
Total assets	<u>\$ 1,000</u>
LIABILITIES	
	\$ --
NET POSITION	
Social Security and Other Earmarked Funds	1,000
All Other	<u>--</u>
Total liabilities and net position	<u>\$ 1,000</u>

**Appendix D:
Example of Note
Disclosure
Summary Financial
Information for
Component Entity**

The following illustrates the component entity summary financial information required in paragraph 22. The illustration has been simplified by not showing prior year comparative statements.

	<u>ABC Fund</u>	<u>CDE Fund</u>	<u>Other Earmarked Funds</u>	<u>Total Earmarked Funds</u>
Balance Sheet as of September 30 (In thousands)				
ASSETS				
Fund balance with Treasury	\$ 20,635	\$ 15,000	\$ 5,000	\$ 40,635
Investments	1,364,823	9,000,000	350,000	10,714,823
Taxes and Interest Receivable			10,000	10,000
Total Assets	<u>\$ 1,385,458</u>	<u>\$ 9,015,000</u>	<u>\$ 365,000</u>	<u>\$ 10,765,458</u>
LIABILITIES and NET POSITION				
Cumulative Results of Operations	<u>\$ 1,385,458</u>	<u>\$ 9,015,000</u>	<u>\$ 365,000</u>	<u>\$ 10,765,458</u>
Total Liabilities and Net Position	<u>\$ 1,385,458</u>	<u>\$ 9,015,000</u>	<u>\$ 365,000</u>	<u>\$ 10,765,458</u>
Statement of Net Cost For the Period Ended September 30				
Program Costs	\$ 383,547	\$ 450,000	\$ 247,000	\$ 1,080,547
Less Earned Revenues			5,000	5,000
Net Program Costs	<u>383,547</u>	<u>450,000</u>	<u>242,000</u>	<u>1,075,547</u>
Less Earned Revenues Not Attributable to Programs				
Net Cost of Operations	<u>\$ 383,547</u>	<u>\$ 450,000</u>	<u>\$ 242,000</u>	<u>\$ 1,075,547</u>

**Statement of Changes in Net
Position For the Period Ended
September 30**

Net Position Beginning of Period	\$ 1,317,760	\$ 8,715,000	\$ 287,000	\$ 10,319,760
Net Cost of Operations	383,547	450,000	242,000	1,075,547
Taxes and Other Nonexchange Revenue	451,245	750,000	320,000	1,521,245
Change in Net Position	<u>67,698</u>	<u>300,000</u>	<u>78,000</u>	<u>445,698</u>
Net Position End of Period	<u>\$ 1,385,458</u>	<u>\$ 9,015,000</u>	<u>\$ 365,000</u>	<u>\$ 10,765,458</u>

Appendix E: List of Abbreviations

FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
MD&A	Management Discussion and Analysis
OMB	Office of Management and Budget
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
Treasury FMS	Treasury Financial Management Service
U.S.	United States

Statement of Federal Financial Accounting Standards 28: Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26

Status

Issued	January 6, 2005
Effective Date	Effective upon issuance.
Volume II References	Social Insurance Programs (S40), Consolidated Financial Report of the US Government (C60)
Interpretations and Technical Releases	None.
Affects	<ul style="list-style-type: none">• SFFAS 25, par. 7• SFFAC 26, par. 6
Affected by	None.

Summary

This standard defers for one year the effective dates of Statement of Federal Financial Accounting Standards (SFFAS) 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, as well as SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*. The provisions of these standards will be effective for periods beginning after September 30, 2005.

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Introduction

1. In July of 2003, the Board issued SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*. SFFAS 25 requires that the Statement of Social Insurance (SOSI) be presented as a basic financial statement. SFFAS 26¹, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, requires disclosure of significant assumptions underlying the SOSI. Both statements were to be effective for periods beginning after September 30, 2004.
2. Three federal agencies – the Office of Management and Budget (OMB), the Social Security Administration (SSA) and the Department of Health and Human Services (HHS) – requested that the implementation of SFFAS 25 and 26 be deferred for one year. Each agency cites the fact that audit guidance was not finalized in time to support the original implementation date.
3. While noting the importance of reclassifying SOSI and related disclosures, the Board agrees that the current effective date is not feasible in light of the delayed audit guidance. Therefore, the effective date is deferred for one year. For ease of reference, Appendix B presents the text of SFFAS 26 as amended by this standard.

¹The relevant text of SFFAS 26 marked with amendments is presented as Appendix B.

Standards

Amendment of SFFAS 25 4. Par. 7 of Statement of Federal Financial Accounting Standards (SFFAS) 25 is amended as follows:

Chapter 8 and paragraphs 14-16 of SFFAS 8 are rescinded, as is the associated illustration of the Current Services Assessment in Appendix B of SFFAS 8, effective for reporting periods beginning after September 30, 2002. Information about Risk Assumed shall be presented as RSI for reporting periods beginning after September 30, 2002. ~~The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement for periods beginning after September 30, 2004, with earlier implementation encouraged. Other information required by SFFAS 17 shall be presented as RSI, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements, for periods beginning after September 30, 2004.~~

Amendment of SFFAS 26 5. Par. 6 of SFFAS 26 is amended as follows:

~~Consistent with the effective date of SFFAS 25, this~~ This standard is effective for periods beginning after September 30, ~~2004~~ 2005.

Effective Date 6. This standard is effective upon issuance.

<p>The provisions of this Statement need not be applied to immaterial items.</p>

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this standard. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement—not the material in this appendix—govern the accounting for specific transactions, events or conditions.

7. The Board conferred with the AICPA regarding the need for audit guidance prior to issuing SFFAS 25. In late 2003, a task force of the AICPA was formed to develop audit guidance. An exposure draft of the guidance was issued by the AICPA in March 2004. The final guidance was not issued in sufficient time to prepare for the initial implementation date despite the extensive efforts of the AICPA.
8. The Board issued an exposure draft proposing this deferral on July 21, 2004. Comments were received from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	2	1
Preparers and financial managers	5	

9. All ten respondents supported the proposed deferral.

Structure of the Amendment

10. SFFAS 25, par. 7 contained provisions concerning the SOSI as well as an effective date for the provisions. SFFAS 26 replaces the reclassification provisions of SFFAS 25 related to the SOSI and provides an effective date for the revised provisions. The amendments in this standard replace the prior effective dates concerning the SOSI reclassification and information in the prior statements with a new effective date of "periods beginning after September 30, 2005." Appendix B presents SFFAS 26 as amended by this standard.

Reasons for the Deferral

11. Agencies requesting the deferred implementation identified the following consequences of the delayed audit guidance:

-
- a. Agency staff was not able to prepare for the audit process due to the uncertainty absent final audit guidance on the process.
 - b. Agency staff was engaged in deliberations with the AICPA task force and unable to begin tentative preparations for the audit.
 - c. Contracts for audit engagements have not been expanded to encompass the audit process to be required relative to the SOSI.
 - d. Funding for the expanded audit engagements could not be included in fiscal year 2005 budget submissions.
12. The Board believes that a one-year delay is reasonable, necessary and appropriate in light of the delayed audit guidance.

Board Approval

13. This statement was approved for issuance by all members of the Board.

**Appendix B: SFFAS
26**

Paragraphs 4 through 6 of SFFAS 26 are presented with the revisions included for ease of reference.

Amendment of SFFAS 25

4. Paragraph 6 of SFFAS 25 is rescinded.
5. The information required by paragraphs 27(3) and 32(3) of SFFAS 17 shall be presented as a basic financial statement rather than as required supplementary stewardship information (RSSI). The underlying significant assumptions shall be included in notes that are presented as an integral part of the basic financial statement. Other information required by SFFAS 17– including the sensitivity analysis required in par. 27(4) and 32(4)– shall be presented as required supplementary information, except to the extent that the preparer elects to include some or all of that information in notes that are presented as an integral part of the basic financial statements.

Effective Date

6. ~~Consistent with the effective date of SFFAS 25, this~~ This standard is effective for periods beginning after September 30, ~~2004~~ 2005.

The provisions of this Statement need not be applied to immaterial items.

**Appendix C:
Abbreviations**

AICPA	American Institute of Certified Public Accountants
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
HHS	Department of Health and Human Services
RSI	Required Supplementary Information
RSSI	Required Supplementary Stewardship Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SSA	Social Security Administration
SOSI	Statement of Social Insurance

Statement of Federal Financial Accounting Standards 29: Heritage Assets and Stewardship Land

Status

Issued	July 7, 2005
Effective Date	For reporting periods beginning after September 30, 2005, with the exception of the specific paragraphs listed in par. 43 of the standard. Full implementation of the standards is effective for periods beginning after September 30, 2008.
Volume II References	Consolidated Financial Report of the US Government (C60), Deferred Maintenance (D20), General Property, Plant, and Equipment (G20), Heritage Assets (H20), Land (L10), Stewardship Land (S60), Stewardship Reporting (S70)
Interpretations and Technical Releases	None.
Affects	<ul style="list-style-type: none">• SFFAS 6• SFFAC 8• SFFAS 14• SFFAS 16
Affected by	None.

Summary

This standard changes the classification of information reported for heritage assets and stewardship land provided by Statement of Federal Financial Accounting Standards 8. This standard reclassifies all heritage assets and stewardship land information as basic except for condition information, which is reclassified as required supplementary information (RSI). This standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be shown. Instead, the note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land. These requirements include a description of major categories, physical unit information for the end of the reporting period, physical units added and withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

This standard also requires two new disclosures for heritage assets and stewardship land. Specifically, this standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.

This standard also includes the requirements for the U.S. Government-wide Financial Statement. It provides for a general discussion and directs users to the applicable entities' financial statements for more detailed information on heritage assets and stewardship land.

This standard amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.

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Introduction

1. The required supplementary stewardship information (RSSI) category, as described in Statement of Federal Financial Accounting Standards (SFFAS) 8, was a response to the unique aspects of the Federal accounting and reporting environment, and to the broad objectives of Federal financial reporting. It was intended to permit flexibility on the part of preparers and auditors that would facilitate reporting relevant, reliable information, including nonfinancial and nonhistorical information¹.
2. Although some stewardship information may not link directly with the basic financial statements because the data to be reported may be other than in dollar terms, the Federal Accounting Standards Advisory Board (the Board or FASAB) intended that RSSI information would augment the basic financial statements and would receive commensurate audit scrutiny.
3. The Board found, however, that in many cases the word “supplementary” in the RSSI title caused certain readers to assume that the information was of secondary importance. Since this was contrary to its intentions, the Board decided to eliminate the RSSI category and re-categorize the stewardship elements within the reporting categories that are well defined in existing professional literature and familiar to report users. Additionally, this standard clarifies the Board’s expectation that information essential to fair presentation will be subject to audit.
4. The main focus of this standard is the reclassification of heritage assets and stewardship land information. This standard reclassifies heritage assets and stewardship land information as basic information with the exception of condition reporting, which is considered RSI². Specifically, this standard requires that entities reference a note on the balance sheet that discloses information about heritage assets and stewardship land, but no asset dollar amount should be shown. The note disclosure provides minimum reporting requirements consistent with the previous standards for heritage assets and stewardship land, which includes a description of major categories, physical unit

¹ See the *Implementation Guide to Statement of Federal Financial Accounting Standards 7: Accounting for Revenue and Other Financing Sources*, par. 22-24, the diagram on page 15, and minutes of associated Board discussions. See also SFFAS 8, *Supplementary Stewardship Reporting*, par. 21, 34, 111-115, and minutes of associated Board discussions.

information for the end of the reporting period, physical units added and withdrawn during the year, a description of the methods of acquisition and withdrawal, and condition information.

5. Although the most significant change within this standard is this reclassification, it also introduces certain changes to the disclosure requirements for heritage assets and stewardship land. Specifically, the standard requires additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land relate to the mission of the entity.
6. This standard also includes disclosure requirements applicable to the U.S. Government-wide Financial Statement. This financial statement must provide a general discussion of heritage assets and stewardship land and direct users to the applicable entities' financial statements for more detailed information on these assets.
7. This standard also amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serve as a means to incorporate all standards specific to heritage assets and stewardship land into one document.
8. The Board believes by fully incorporating into this standard all requirements for heritage assets (including multi-use heritage assets) and stewardship land, readers will better understand all reporting requirements. However, the main issues deliberated by the Board were the reclassification and presentation of heritage assets and stewardship land information. The Board has not reconsidered the definition, recognition and measurement provisions of the existing standards. These provisions have been brought forward from those standards that were based on prior Boards' conclusions.

² RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*, published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, Governmental Accounting Standards Board (GASB), and FASAB. The auditor's responsibility for RSI is discussed in section AU 558 of the codification of professional auditing standards published by the American Institute of Certified Public Accountants (AICPA).

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9. The Board developed this standard for heritage assets and stewardship land based on the importance of the data in meeting the stewardship reporting objective as described in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*. Further information on the Board's considerations regarding this reclassification is included in the Basis for Conclusions.

Standards of Federal Financial Accounting

Heritage Assets (including Multi-use Heritage Assets)

Amendments to Existing Standards

10. SFFAS 6 par. 21 is amended as follows:

The following paragraphs provide recognition and measurement principles, and disclosure requirements for general PP&E. For standards relating to heritage assets, multi-use heritage-assets and stewardship land, see SFFAS 29, *Heritage Assets and Stewardship Land*. ~~each category of PP&E. The categories identified are:~~

- ~~general PP&E (including land acquired for or in connection with other general PP&E),~~
- ~~National Defense PP&E,~~
- ~~heritage assets, and~~
- ~~stewardship land (i.e., land not included in general PP&E).~~

11. SFFAS 6 par. 57 through 65 are rescinded.

12. SFFAS 8 Chapter 2 (Heritage Assets) is rescinded in its entirety.

13. SFFAS 14 par. 10 and 11 are rescinded.

14. SFFAS 16 is rescinded in its entirety.

Definitions

15. Heritage assets are property, plant and equipment (PP&E) that are unique for one or more of the following reasons:

- historical or natural significance,
- cultural, educational, or artistic (e.g., aesthetic) importance; or
- significant architectural characteristics.

Heritage assets consist of (1) collection type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections; and (2) non-collection-type heritage assets, such as parks, memorials, monuments, and buildings.

16. Heritage assets are generally expected to be preserved indefinitely. One example of evidence that a particular asset is heritage in nature is that it is listed on the National Register of Historic Places.
17. Some investments in heritage assets (e.g., national parks) will meet the definitions and be considered and reported as both heritage assets and stewardship land (see Stewardship Land below). Such reporting would not be considered duplication, as the type of information reported for the physical unit would be different for each category of stewardship asset.
18. Heritage assets may in some cases be used to serve two purposes—a heritage function and general government operations. In cases where a heritage asset serves two purposes, the heritage asset should be considered a **multi-use heritage** asset if the predominant use of the asset is in general government operations (e.g., the main Treasury building used as an office building). Heritage assets having an incidental use in government operations are not multi-use heritage assets; they are simply heritage assets.

Recognition and Measurement

Heritage Assets

19. With the exception of multi-use heritage assets (addressed in par. 22) the cost of acquisition, improvement, reconstruction, or renovation of heritage assets should be recognized on the statement of net cost for the period in which the cost is incurred. The cost³ should include all costs incurred during the period to bring the item to its current condition (See par. 26 of SFFAS 6 for examples of the costs to be considered).

³ For a full discussion of cost, including full cost, direct cost and indirect cost, see SFFAS 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. Also, see par. 94-95, SFFAC 2, Entity and Display.

-
20. With the exception of multi-use heritage assets (addressed in par. 23) no amounts for heritage assets acquired through donation or devise⁴ should be recognized in the cost of heritage assets.⁵
21. With the exception of multi-use heritage assets (addressed in par. 24) transfers of heritage assets from one Federal entity to another do not affect the net cost of operations or net position of either entity. However, in some cases, assets included in general PP&E may be transferred to an entity for use as heritage assets. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.⁶

Multi-use Heritage Assets

22. The cost of acquisition, improvement, reconstruction, or renovation of multi-use heritage assets should be capitalized as general PP&E and depreciated over its estimated useful life.
23. Multi-use heritage assets acquired through donation or devise should be recognized as general PP&E at the assets' fair value at the time received, and the amount should also be recognized as "nonexchange revenues" as defined in SFFAS 7, *Accounting for Revenue and Other Financing Sources*.
24. Transfers of multi-use heritage assets from one Federal entity to another are transfers of capitalized assets. The receiving entity should recognize a transfer-in as an additional financing source and the transferring entity should recognize a transfer-out. The value recorded should be the transferring entity's book value of the multi-use heritage asset. If the receiving entity is not provided the book value, the multi-use heritage asset should be recorded at its estimated fair value⁷.

⁴ A will or clause of a will disposing of property.

⁵ SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258-259 explains that stewardship PP&E is "expensed if purchased, but no amount is recognized if it is received as a donation."

⁶ SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.

⁷ See SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 for a discussion of transfers of assets.

**Disclosures and Required
Supplementary Information**

25. Entities with heritage assets should reference a note⁸ on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown⁹. The note disclosure related to heritage assets should provide the following:
- a. A concise statement explaining how they relate to the mission of the entity.
 - b. A brief description of the entity's stewardship policies for heritage assets. Stewardship policies for heritage assets are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of heritage assets consistent with statutory requirements, prohibitions, and limitations governing the entity and the heritage assets.
 - c. A concise description of each major category of heritage asset. The appropriate level of categorization of heritage assets should be meaningful and determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets.
 - d. Heritage assets should be quantified in terms of physical units. The appropriate level of aggregation and physical units¹⁰ of measure for each major category should be meaningful and determined by the preparer based on the entity's mission, types of heritage assets, and how it manages the assets. For each major category of heritage asset (identified in c. above) the following should be reported:
 1. The number of physical units by major category; major categories should be classified by collection or non-collection

⁸ This standard does not prescribe a specific reference or line item entitled "Heritage Assets" as it may be included with other items for which no dollar amounts are recognized (such as stewardship land and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

⁹ No asset dollar amount is shown, except for multi-use heritage assets, which are capitalized and reported as part of general PP&E. See par. 22 through 24 and par. 27 for additional explanation.

¹⁰ Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities.

type heritage assets for which the entity is the steward as of the end of the reporting period;

2. The number of physical units by major category that were acquired and the number of physical units by major category that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of heritage assets during the reporting period. This should include disclosure of the number of physical units (by major category) of transfers of heritage assets between Federal entities and the number of physical units (by major category) of heritage assets acquired through donation or devise, if material. In addition, the fair value of heritage assets acquired through donation or devise during the reporting period should be disclosed, if known and material.

26. Entities should report the condition¹¹ of the heritage assets (which may be reported with the deferred maintenance information¹²) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information¹³ if reported elsewhere in the report containing the basic financial statements.

¹¹ Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.

¹² See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

¹³ SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment and SFFAS 8, Supplementary Stewardship Reporting*, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

U.S. Government-wide
Financial Statement
Disclosures¹⁴

27. Entities should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.
28. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about heritage assets, but no asset dollar amount should be shown. The note disclosure related to heritage assets should provide the following:
- a. A concise statement explaining how they relate to the mission of the Federal Government.
 - b. A description of the broad categories of heritage assets of the Federal Government.
 - c. A general reference to agency reports for additional information about heritage assets, such as agency stewardship policies for heritage assets, physical units by major categories of heritage assets, and the condition of the heritage assets.
29. The U.S. Government-wide financial statement should disclose that multi-use heritage assets are recognized and presented with general PP&E in the basic financial statements and that additional information for the multi-use heritage assets is included with the heritage assets information.

Stewardship Land

Amendments to Existing
Standards

30. SFFAS 6 par. 66 through 76 are rescinded.
31. SFFAS 8 Chapter 4 (Stewardship Land) is rescinded in its entirety.
32. SFFAS 14 par. 10 and 11 are rescinded.

¹⁴ SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

Definitions

33. Stewardship Land is land and land rights¹⁵ owned by the Federal Government but not acquired for or in connection with¹⁶ items of general PP&E. Examples of stewardship land include land used as forests and parks, and land used for wildlife and grazing.
34. "Land" is defined as the solid part of the surface of the earth. Excluded from the definition are the natural resources (that is, depletable resources, such as mineral deposits and petroleum; renewable resources, such as timber; and the outer-continental shelf resources) related to land.¹⁷
35. Land and land rights owned by the Federal Government and acquired for or in connection with items of general PP&E should be accounted for and reported as general PP&E.
36. Land and land rights owned by the Federal Government and not acquired for or in connection with items of general PP&E should be reported as stewardship land.

Recognition and Measurement

37. The cost of acquisition of stewardship land should be recognized on the statement of net cost for the period in which the cost is incurred. The cost should include all costs to prepare stewardship land for its intended use (e.g., razing a building). In some cases, land may be acquired along with existing structures. The following treatments should apply:
- a. if the structure would be deemed a heritage asset and is significant in and of itself, the entity should use its judgment as to whether the

¹⁵Land rights are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, mineral rights, and other like interests in land.

¹⁶ "Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

¹⁷ The Board presently has an active project to address standards for natural resources, for which the Board is considering developing individual standards for each type of natural resource separately. To begin the project, the Board will be addressing oil and gas resources. The framework for the oil and gas resource phase of the project will be used as a model when addressing the other types or logical sets of natural resources (e.g., timber, grazing land, solid leasable minerals) in subsequent phases of the project.

acquisition cost should be treated as the cost of stewardship land, heritage asset, or both;

b. if the structure is to be used in operations (for example, as general PP&E) but 1) the value of the structure is insignificant, or 2) its acquisition is merely a byproduct of the acquisition of the land, the cost in its entirety should be treated as an acquisition of stewardship land; or

c. significant structures that have an operating use (e.g., a constructed hotel or employee housing block) should be treated as general PP&E by identifying the cost attributable to general PP&E and segregating it from the cost of the stewardship land acquired.

38. No amounts for stewardship land acquired through donation or devise¹⁸ should be recognized in the cost of stewardship land.¹⁹
39. Transfers of stewardship land from one Federal entity to another, does not affect the net cost of operations or net position of either entity. However, in some cases, land included in general PP&E may be transferred to an entity for use as stewardship land. In this instance, the transferring entity should recognize a transfer-out of capitalized assets.²⁰
40. Entities with stewardship land should reference a note²¹ on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:

Disclosures and Required
Supplementary Information

¹⁸ A will or clause of a will disposing of property.

¹⁹ SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 258-259 explains that stewardship PP&E is “expensed if purchased, but no amount is recognized if it is received as a donation.”

²⁰ SFFAS 7, *Accounting for Revenue and Other Financing Sources*, par. 74 and par. 345-346.

²¹ This standard does not prescribe a specific reference or line item entitled “Stewardship Land” as it may be included with other items for which no dollar amounts are recognized (such as heritage assets and other items that in the future may require similar non-financial disclosure) for presentation. Instead, the standard allows entities flexibility in determining the best presentation.

a. A concise statement explaining how it relates to the mission of the entity.

b. A brief description of the entity's stewardship policies for stewardship land. Stewardship policies for stewardship land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of stewardship land consistent with statutory requirements, prohibitions, and limitations governing the entity and the stewardship land.

c. A concise description of each major category of stewardship land use. Where parcels of land have more than one use, the predominant use of the land should be considered the major use. In cases where land has multiple uses, none of which is predominant, a description of the multiple uses should be presented. The appropriate level of categorization of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets.

d. Stewardship land should be quantified in terms of physical units. The appropriate level of aggregation and physical units of measure for each major category of stewardship land use should be meaningful and determined by the preparer based on the entity's mission, types of stewardship land use, and how it manages the assets. For each major category of stewardship land use the following should be reported:

1. The number of physical units by major category of stewardship land use for which the entity is the steward as of the end of the reporting period;

2. The number of physical units by major category of stewardship land use that were acquired and the number of physical units by major category of stewardship land use that were withdrawn during the reporting period; and

3. A description of the major methods of acquisition and withdrawal of stewardship land during the reporting period. This should include disclosure of physical units (by major category of stewardship land use) of transfers of stewardship land between Federal entities and the number of physical units (by major category of stewardship land use) of stewardship land acquired through donation or devise, if material. In addition, the fair value

of stewardship land acquired through donation or devise during the reporting period should be disclosed, if known and material.

U.S. Government-wide
Financial Statement
Disclosures²⁵

41. Entities should report the condition²² of the stewardship land (which may be reported with the deferred maintenance information²³) as required supplementary information. Entities should include a reference to the condition and deferred maintenance information²⁴ if reported elsewhere in the report containing the basic financial statements.
42. The U.S. Government-wide financial statement should reference a note on the balance sheet that discloses information about stewardship land, but no asset dollar amount should be shown. The note disclosure related to stewardship land should provide the following:
 - a. A concise statement explaining how it relates to the mission of the Federal Government.

²² Condition is the physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset's condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence. Examples of condition information include, among others, (1) averages of standardized condition rating codes; (2) percentage of assets above, at, or below acceptable condition; or (3) narrative information.

²³ See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

²⁴ SFFAS 14, *Amendments to Deferred Maintenance Reporting Amending SFFAS 6, Accounting for Property, Plant and Equipment* and SFFAS 8, *Supplementary Stewardship Reporting*, defined deferred maintenance as RSI. The Board believed that a period of experimentation was necessary for deferred maintenance information and that classifying it as RSI would be more appropriate during the experimentation period. The Board may revise this standard based on experience gained during this time and the development of additional criteria.

²⁵ SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, clarified that all existing and future standards apply to all Federal entities, including the U.S. Government-wide Financial Statement, unless a standard specifically provides otherwise.

b. A description of the predominant uses of the stewardship land of the Federal Government.

c. A general reference to agency reports for additional information about stewardship land, such as agency stewardship policies for stewardship land, physical units by major categories of stewardship land use, and the condition of the stewardship land.

Effective Date

43. These standards are effective for reporting periods beginning after September 30, 2005 with the exception of the specific paragraphs listed below. These exceptions provide for a phase-in of disclosure requirements being reported as basic information such that these standards will be fully implemented for reporting periods beginning after September 30, 2008.
- a. Section c and section d1 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2007;
- b. Section d2 and section d3 in par. 25 and 40 are effective for reporting periods beginning after September 30, 2008; and
- c. Information that is provided an exception (described in par. a. and b. above) to being reported as basic information during the phase-in period is still required, but should be reported as RSI until the exceptions expire.
44. Full implementation of the standards is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement—not the material in this appendix—should govern the accounting for specific transactions, events or conditions.

Introduction

45. In SFFAS 8, *Supplementary Stewardship Reporting*, the Board described stewardship information and required the reporting of that information. When the Board established the RSSI category, it believed that the new category was needed to highlight the unique nature of the reported items, to accommodate non-financial data, and to allow for reporting experimental information, such as condition. The Board believed that as agencies gained experience in reporting stewardship information that the reporting would evolve to a level where there was consistency within categories and at the government-wide consolidated reporting level. The Board has found that this evolution is, in fact, happening.
46. Consequently, the Board also has considered entities' improved accounting and reporting methods in deciding how to categorize the stewardship elements. The Board has found that, in many cases, entities have adopted the stewardship standards with a sense of responsible creativity. There are many instances where entities have developed imaginative, informative, and meaningful displays of stewardship information. The Board commends the efforts of these entities and supports their continued efforts to report on the Nation's stewardship resources and responsibilities in a responsible and informative manner.
47. The Board believes that avoiding the use of the RSSI category will eliminate some potential confusion and ambiguity. In particular, it should clarify the Board's expectation that significant information essential to fair presentation will be subject to audit.
48. The Board eliminated the use of RSSI to report information about weapons systems when it issued SFFAS 23, *Eliminating the Category "National Defense Property, Plant, and Equipment."* Additionally, SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, eliminated the use of RSSI for reporting stewardship responsibilities. Classification of other items of information currently designated RSSI (stewardship investments) may be dealt with in one or more future standards.
49. This standard eliminates the use of RSSI for reporting Stewardship PP&E. Stewardship PP&E consists of items whose physical properties resemble those of general PP&E traditionally capitalized in basic financial statements. However, the nature of Federal physical assets classified as stewardship PP&E (e.g., museum collections,

monuments, assets acquired in the formation of the nation, etc.) differ from general PP&E. Stewardship PP&E includes heritage assets (e.g., Federal monuments and memorials and historically or culturally significant property) and stewardship land (i.e., land not acquired for or in connection with general property, plant, and equipment).²⁶

Amendments to Standards

50. This standard amends several existing standards. The amendments rescind certain standards or parts of certain standards due to the classification change, as well as serves as a means to incorporate all standards specific to heritage assets and stewardship land into one standard.
51. This standard amends SFFAS 8 by rescinding chapters 2 and 4 of that standard. This change eliminates the use of the RSSI category to report information about heritage assets and stewardship land. This standard also incorporates the revised multi-use heritage asset standards of SFFAS 16, *Amendments to Accounting for Property, Plant, and Equipment: Measurement and Reporting for Multi-use Heritage Assets*.²⁷ Accordingly, SFFAS 16 is rescinded in its entirety. Additionally, par. 57 through 76 of SFFAS 6, *Accounting for Property, Plant and Equipment* also is rescinded because they relate to heritage assets and stewardship land.
52. SFFAS 14, *Amendments to Deferred Maintenance Reporting*, also amended certain paragraphs within Chapters 2 and 4 of SFFAS 8 that related to deferred maintenance and condition reporting. This standard also incorporates those revisions. Accordingly, the portion of SFFAS 14 entitled 'Amendments to SFFAS 8' (SFFAS 14 par. 10 and 11) is rescinded.²⁸

²⁶ SFFAS 8, par. 11

²⁷ SFFAS 16 has been incorporated into the current standard for ease in understanding because SFFAS 16 amended Chapter 2 Heritage Assets of SFFAS 8 and portions of SFFAS 6.

²⁸ SFFAS 14 did amend the status of deferred maintenance by classifying it as RSI, however, SFFAS 6, *Accounting for Property, Plant and Equipment*, provides for the information to be reported. See SFFAS 6, Chapter 3, Deferred Maintenance (par. 77-84) for information regarding definition, measurement and disclosures specific to deferred maintenance.

53. As a result, this standard incorporates all standards for heritage assets and stewardship land into one document. The Board believes by fully incorporating all requirements for heritage assets (including multi-use heritage assets) and stewardship land, readers will better understand all existing reporting requirements. However, the main issues deliberated by the Board were the reclassification and presentation of heritage assets and stewardship land information. The Board has not reconsidered the definition, recognition and measurement provisions of the current standards at this time. These provisions have been brought forward from previous standards that were based on prior Boards' conclusions. In the future, the Board may reconsider the recognition and measurement issues for heritage assets and stewardship land.

Basic vs. RSI

54. The Board believes that information on heritage assets and stewardship land (except for condition) should be basic information for the following reasons:
- a. Information on these assets is essential to fair presentation and may be crucial to understanding the entirety of an entity's financial condition.
 - b. Accountability for heritage assets and stewardship land requires more audit scrutiny than would be afforded if they were considered RSI.²⁹
 - c. This classification is consistent with existing standards issued by the Governmental Accounting Standards Board (GASB) that is specific to reporting on art and historical treasures; and the Financial Accounting Standards Board (FASB) that is specific to collections, and other works of art and historical treasures. There is also existing audit guidance available in this area.³⁰

²⁹ See SFFAS 8, par. 114 which details the fact the Board believed "that certain stewardship information, should receive more audit scrutiny than it would if it were RSI..."

³⁰ For additional information on these existing standards and guidance see Statement of Financial Accounting Standards 116, Accounting for Contributions Received and Contributions Made, GASB 34 par. 27-29 (*Reporting Works of Art and Historical Treasures*), and AICPA Audit and Accounting Guide, *Not-for-Profit Organizations*.

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55. It should be noted that during Board discussions and deliberations related to SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, and the reclassification of the stewardship responsibilities, the Board developed a detailed list of practical and conceptual factors for consideration in determining RSI versus basic information classification. This structure was also considered in the decisions relating to the appropriate classification of heritage assets and stewardship land information and will be invoked in any future classification decisions by the Board.³¹
56. Specifically, the Board agreed that heritage assets and stewardship land information was essential and relevant to fair presentation. Additionally, the Board believed that it was important that this be clearly communicated to the readers of the financial statements and auditor reports. The Board also noted the importance and relevance of the information in light of the *Objectives of Federal Financial Reporting*.³²
57. Condition reporting for heritage assets and stewardship land should be reported as required supplementary information because this information is experimental in nature and there is inconsistency in the manner of assessing and reporting this information.

U.S. Government-wide
Financial Statement

58. In determining the required disclosures for the U.S. Government-wide Financial Statement, the Board considered SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, which designated the intended or primary audience of the U.S. Government-wide Financial Statement and qualitative characteristics for the U.S.

³¹ See SFFAS 25, Appendix A paragraphs 34-50 for detail on the factors. To help readers understand the Board's deliberations, those paragraphs provide more details about some practical and conceptual factors that affected the Board's decision whether to designate an item as RSI or as an integral part of the basic financial statements.

³² See Stewardship (Objective 3) as described in SFFAC 1, *Objectives of Federal Financial Reporting*.

Government-wide Financial Statement that would be most useful for that audience.³³

59. Par. 6 of SFFAC 4 explains that the U.S. Government-wide Financial Statement “is a general purpose report that is aggregated from agency reports and tells users where to find information in other formats, both aggregated and disaggregated, such as individual agency reports, agency websites, and the President’s Budget.”
60. The Board considered the nature and the variety of the data that would be aggregated from the various entities in preparing the heritage assets and stewardship land disclosures for the U.S. Government-wide Financial Statement. The Board determined that the standards for the U.S. Government-wide Financial Statement should provide for a general discussion and direct users to the applicable entities’ financial statements for more detailed information on heritage assets and stewardship land.

Exposure Draft

61. FASAB published the exposure draft (ED) *Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information* on August 20, 2003. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, *Government Accounting and Auditing Update*, and *JFMIP News*; the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past.
62. Twelve letters were received from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others	1	3
Auditors	1	1
Preparers and financial managers	6	

³³ See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government* par. 5

63. A public hearing was held on March 4, 2004. Individuals from the Library of Congress, U.S. Department of Agriculture, Department of Interior (including representatives from the CFO, OIG and IPA currently performing the DOI audit), and a representative from the Institute for Truth in Accounting testified at the public hearing. The participants reiterated issues included in the comment letters to the ED.

Responses to the ED

64. A majority of the respondents did not agree with heritage assets and stewardship land information being reported as basic. Key issues raised by respondents included the following:
- a. A need for more specific guidance on categorization and unitization for reporting heritage assets and stewardship land information;
 - b. The audit implications of the standard, including the additional audit costs by classifying the information as basic; and
 - c. Less useful information being presented by agencies with the reclassification.
65. Most respondents that did not agree with heritage assets and stewardship land information being reported as basic, recommended that it be classified as RSI (or remain as RSSI).
66. Most respondents agreed with the Board's new disclosure requirements and did not foresee any problems with the new disclosure requirements
67. Most respondents did not agree with the proposed effective date for periods beginning after September 30, 2004 in the ED. Key reasons cited for the delay of the effective date included the need for additional time to address implementation issues and time for including funding in their budgets to cover the additional costs for implementation and audit.

Board Consideration of Comments

68. Considering that the majority of respondents did not agree with the ED, the Board directed staff to research various issues that would assist the Board in addressing the comments raised by respondents.

For example, the Board considered the current FASB and GASB standards in this area. The Board also considered results of a review of private museum reporting practices.

69. The Board also considered several recent government-wide initiatives that promote accountability and stewardship over real property assets and heritage assets such as the Federal Real Property Asset Management Initiative, Executive Order 13327 Federal Real Property Asset Management, and Executive Order 13287 Preserve America. The Board believes these initiatives provide further support for the decision to classify the heritage assets and stewardship land as basic information and the importance of accountability for these types of assets.
70. The Board also considered the issue of unitization and categorization further by reviewing draft guidance prepared by the Heritage Assets Categorization Project Team and the Accounting and Auditing Policy Committee (AAPC) Stewardship Guidance Workgroup. The Board believes that the draft products from these workgroups are excellent starting points for developing comprehensive guidance on many of the issues raised by respondents.
71. In response to the audit concerns, FASAB held a roundtable meeting with representatives from the Office of Inspector General (OIG) and CPA firms responsible for financial statement audits to solicit their views on specific issues raised by respondents as well as potential audit costs involved with implementing the standard.
72. As a result of the comments received and testimony provided at the public hearing, as well as the above actions, the Board did make certain revisions, which are detailed in the following paragraphs. Additionally, reasons for not making revisions on specific issues are detailed below.

Importance to Mission

73. The ED contained the new disclosure that required a statement explaining how heritage assets and stewardship land are “important to the overall mission of the entity.” A respondent explained that agencies may have significant stewardship assets as a result of their compliance with cultural resource protection laws and regulations or because Congress has determined that certain classes of assets to be nationally significant, regardless of the agency mission. The

respondent believed that showing the link between the agency mission and the assets may result in less disclosure by agencies that lack a direct link to their mission.

74. The Board understands that some agencies may have heritage assets because of the facts described by the respondent and it is possible that the assets may not be important to the overall mission of the agency. However, the Board considered the new requirement to be explanatory in nature by offering more information about the assets. The Board did not envision the importance to the mission to be considered in determining which heritage assets and stewardship land should be included.
75. The Board revised the language of the new requirement to read “A concise statement explaining how they relate to the mission of the entity.” The Board believes with this language, the requirement is flexible enough that if the assets are not related to the mission of the entity, the entity may state that and provide additional explanation, if they so choose.

**Limiting Information
Presented**

76. Several respondents commented that agencies would present less information in their annual reports because the heritage assets information and stewardship land information would be subject to audit since it is classified as basic information. The classification of heritage assets and stewardship land information as basic should not limit the information entities choose to present or prevent the continuation of informative and meaningful displays of information.
77. This standard does not eliminate any information that was previously required for heritage assets and stewardship land. In drafting the standard, the Board envisioned the required disclosures to be presented in a concise format similar to the format that most entities present for general property, plant and equipment.
78. The Board notes that preparers continue to have the option of voluntarily presenting information beyond the minimum reporting requirements as other accompanying information.

Categorization and Unitization

79. The standard does not define asset categories or physical units for reporting. The Board recognizes that there may be difficulties for agencies in determining the appropriate level of aggregation for reporting categories of heritage assets. However, the Board believes that the agencies are in the best position to determine the most meaningful level of presentation. The Board believes that ultimately the presentation depends upon the specifics of the entity—its mission, the types of heritage assets, how it manages, and materiality considerations. It would be difficult for the standard to define such specific reporting requirements, as they may be unique to each entity.
80. The Board also has avoided detailed illustrations and limited specific examples in the standard because preparers and auditors may attempt to strictly adhere to the illustrations.
81. The standard emphasizes reporting on asset categories, rather than individual assets. Based on comments to the ED, it appeared that this may not have been clear to the readers. Therefore, additional language was added to the final standard to clarify that the appropriate level of categorization of stewardship assets and the associated physical units should be determined by the preparer based on the entity's mission, types of use, and how it manages the assets.
82. Entities should designate asset reporting categories that allow inclusion and aggregation of their heritage assets and stewardship land. Entities should determine the appropriate level of detail for their categorization. It is helpful if entities designate asset categories that are meaningful and reflect how the entity views the assets for management purposes. It would also be helpful for entities to document the reasoning for the categorization.
83. The Board recognizes that the information that is appropriate for reporting heritage assets and stewardship land can vary from one entity to another. The amount and level of detail of the information presented depends, in part, on the mission of the entity and the materiality of the assets in question. For example, categories reported by an agency that has a stewardship mission, might be more disaggregated than is appropriate for one that does not.
84. Defining physical units as individual items to be counted is neither required nor prohibited. Particularly for collection-type heritage assets, it may be more appropriate to define the physical unit as a

collection, or a group of assets located at one facility, and then count the number of collections or facilities. The level of detail may differ by entity.

85. It is the intent of the Board to provide entities with considerable latitude and flexibility in designating categories, determining a meaningful level of aggregation for reporting, and selecting physical units aligned with those categories. For example, should a library report that it has a collection of papers or that it has 10,000 pieces of paper in that collection? Further, should a museum report that it has 10 dinosaur skeletons or 10,000 dinosaur bones, or a single collection of skeletons in one facility? Ultimately, the answer is influenced by how the entity manages as well as materiality considerations. Agencies may be required to count the number of individual items for control purposes. But due to materiality considerations, entities may choose to report a higher level of aggregation such as the number of collections or facilities in which individual items are located. Although individual item counts may not be necessary to support the reporting requirements in the standard, this does not mean that item counts for management control and safeguarding purposes are not necessary to fulfill mandates required by other public laws and regulations.

Supporting Documentation

86. The Board has recognized in previous standards that historical records for items acquired long ago may not have been retained.³⁴ Based on responses to the ED, testimony provided at the public hearing, and discussions with the auditors at the roundtable meeting, the Board believes this may be an issue in implementing this standard.
87. The Board understands that with the heritage assets and stewardship land information being classified as basic, auditors may require certain supporting documentation to fulfill audit assertions. There may be instances where the historical documents are not available for items acquired many years ago, prior to the effective date of this

³⁴SFFAS 23 *Eliminating the Category National Defense PP&E*, par. 11 provided implementation guidance as follows: “This standard recognizes that determining initial historical cost may not be practical for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate.”

standard, in an environment in which the historical records were not required to be retained and may therefore be inadequate.

88. Therefore, the Board encourages preparers, program offices, and auditors to develop other reasonable approaches and methods for satisfying the specific audit assertions that would rely on historical documents as evidence and support. In addition, the Board plans to suggest that this issue be addressed further in the forthcoming AAPC Guidance (discussed below).

Additional Guidance

89. The Board notes that there has been work by certain government-wide task forces (such as the AAPC Stewardship Guidance Work Group and the Heritage Assets Categorization Team) to address issues identified such as standardized categories, definitions of units of measurements, and other areas where prescriptive guidance has been requested. The task forces contained representatives from pertinent agencies and experts in the field, which most likely provided for a comprehensive assessment.
90. Considering the extensive research performed by the task forces, their draft proposals or guides which address areas such as categories and subcategories and related physical units should be a good starting point for additional guidance that could be included in a Technical Release from the AAPC.
91. The Board will request that the AAPC revitalize the efforts of the Stewardship Guidance Work Group and work towards finalization of their draft guidance, which may ultimately be published as a Technical Release. The guidance will be expanded where necessary to cover the issues identified by respondents in the comment letters. For example, the Board will suggest that the AAPC review case studies where supporting documentation may not be available and determine other reasonable approaches, methods, and best practices for satisfying specific assertions that would rely on historical documents as evidence and support.
92. The Board will suggest that the AAPC also consider the work done by the Heritage Assets Categorization Team. FASAB staff will work closely with the task force with the goal of finalizing the guide within one year of the issuance of this standard.

**Effective Date/Phased-In
Implementation**

93. Most respondents to the ED and participants at the public hearing did not agree with the proposed effective date in the ED for periods beginning after September 30, 2004. Key reasons cited for the delay of the effective date were the need for additional time to address issues noted in their arguments against classifying the information as basic and time for including funding in their budgets for the additional work and audit costs to be incurred.
94. The Board believed the reasons provided for the delay of the effective date were valid and justified some delay. Therefore, the Board believed a phased implementation would provide time for entities to address some of the issues identified and for consideration of the strained resources facing most agencies.
95. The Board also believed that the effective date for certain disclosures to be classified as basic should be delayed to allow time for the issuance of the additional guidance by the AAPC. Therefore, the standard was revised to allow for a phase-in of required reporting disclosures as basic.
96. The standards are effective for reporting periods beginning after September 30, 2005, with the exception of the section c (category descriptions) and section d1 (physical units by major category for the end of the reporting period) in par. 25 and 40 that are effective for reporting periods beginning after September 30, 2007; and section d2 (physical units by major category that were acquired and withdrawn during the reporting period) and section d3 (major methods of acquisition and withdrawal during the reporting period) in par. 25 and 40 that are effective for reporting periods beginning after September 30, 2008.
97. These exceptions provide for a phase-in of disclosure requirements being reported as basic information such that the standard will be fully implemented for reporting periods beginning after September 30, 2008. Information that is provided an exception (see par. above) to being reported as basic information during the phase-in period is still required, but should be reported as RSI until the exceptions expire. It may be appropriate for entities to include a reference to the information reported as RSI during the phase-in period.
98. The phased-in implementation offers additional time for agencies to determine the proper level of aggregation for major categories, as well

as determining the appropriate physical unit of measure and documenting their reasoning for such. This additional time will also allow for the AAPC to issue its guidance in time for consideration before implementation. It is anticipated that the AAPC will finalize the guide prior to the implementation of the required reporting by major categories.

Materiality

99. In the ED, the disclosure requirements language read “Entities with significant heritage assets/stewardship land should reference a note...” The Board used the term “significant” to emphasize that some entities may not be subject to the disclosure requirements due to certain entities having only immaterial amounts of heritage assets and stewardship land covered by this standard.
100. Although most respondents to the ED agreed that the preparer should have flexibility in determining appropriate categories for aggregation and that the preparer should be allowed to exercise professional judgment in determining which assets are significant, there was some concern raised by respondents that these judgments may be difficult to make. Certain respondents noted that “significant” is difficult to apply in the case of heritage assets and stewardship land because there are no financial dollar amounts required to be reported.
101. The term “significant” was removed from the language establishing disclosure requirements in the final standard because the Board has stated within this standard “The provisions of this Statement need not be applied to immaterial items.” Therefore, entities may omit heritage asset and stewardship land information if they are immaterial.
102. In SFFAS 3, *Accounting for Inventory and Related Property*, the introduction included a discussion on “materiality”.³⁵ It explained that materiality has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. It further explained that the determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

³⁵See SFFAS 3, *Accounting for Inventory and Related Property*, par. 7-15.

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103. In its discussion in SFFAS 3, the Board relied on the FASB's concept as modified by certain concepts expressed in governmental auditing standards³⁶. Par. 9 of SFFAS 3 discussed FASB's Statement of Financial Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," that provides for materiality as the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.
104. Par. 9 of SFFAS 3 also explains that this concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user. The Board believes that preparers should consider both quantitative and qualitative characteristics when applying materiality to this standard.

Board Approval

105. This statement was approved for issuance by all members of the Board.

³⁶Par. 12 of SFFAS 3 explains that the Government Auditing Standards provide "In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private-sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions."

Statement of Federal Financial Accounting Standards 30: Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts

Status

Issued	August 15, 2005
Effective Date	For reporting periods beginning after September 30, 2008.
Volume II References	Managerial Cost Accounting (M20)
Interpretations and Technical Releases	Interpretation 6, <i>Accounting for Imputed Intra-departmental Costs</i>
Affects	• SFFAS 4
Affected by	None.

Summary

This standard requires full implementation of the inter-entity cost provision in Statement of Federal Financial Accounting Standards (SFFAS) 4, Managerial Cost Accounting Standards and Concepts. By fully implementing the provisions in SFFAS 4 (issued in July 1995) this standard will require the following for inter-entity cost:

Each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. The entity providing the goods or services has the responsibility to provide the receiving entity with information on the full cost of such goods or services either through billing or other advice.

Recognition of inter-entity costs that are not fully reimbursed is limited to material items that (1) are significant to the receiving entity, (2) form an integral or necessary part of the receiving entity's output, and (3) can be identified or matched to the receiving entity with reasonable precision. Broad and general support services provided by an entity to all or most other entities should not be recognized unless such services form a vital and integral part of the operations or output of the receiving entity. (Text preceding paragraph 105 of SFFAS 4)

This standard requires full implementation for reporting periods beginning after September 30, 2008.

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Introduction

1. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. SFFAS 4 provided for gradual implementation because recognition of the full cost of goods and services provided by one federal entity (the providing entity) to another federal entity (the receiving entity) (1) required adequate cost accounting systems and (2) engaged all federal agencies in identifying the costs of under-reimbursed goods and services.
2. Thus, an orderly means for consistently implementing the standard was viewed as necessary. The Board's implementation guidance provided "the Office of Management and Budget [OMB], with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs."¹ The inter-entity costs were to be specified in accordance with SFFAS 4, including the recognition criteria.² It was anticipated that the largest and most important inter-entity costs would be identified first.
3. OMB requested that the Accounting and Auditing Policy Committee (AAPC) provide assistance in developing the guidance anticipated by SFFAS 4. The AAPC Inter-entity Cost Task Force (task force) was formed and initial research was conducted beginning in July 2000. The task force reported its research findings and recommendations to the AAPC at its May 2003 meeting. The task force noted that the current limitation³ on recognizing inter-entity costs was an impediment to progress towards full costing. However, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. The task force

¹ SFFAS 4, par. 110

² See SFFAS 4 par. 111-113 for recognition criteria

³ To date, OMB has issued guidance for recognizing the following specific inter-entity costs: (1) employees' pension, post-retirement health and life insurance benefits, (2) other post-employment benefits for retired, terminated, and inactive employees, which includes unemployment and workers compensation under the Federal Employees' Compensation Act, and (3) losses in litigation proceedings. The guidance further states that to ensure consistency, agencies should not recognize costs other than those listed until further guidance is provided. See Section 4.3 of OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*.

report is available on the AAPC website at <http://www.fasab.gov/aapc/iecs.html>.

4. This standard follows the extensive research and recommendations by the AAPC task force addressing inter-entity cost guidance. Although the task force report acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing, it recommended continued deferral of SFFAS 4's inter-entity cost requirements while encouraging reimbursable agreements for inter-entity provision of goods and services.
5. This standard is intended to balance the concerns expressed by the task force and the ultimate goals of SFFAS 4 related to full cost. SFFAS 4 clarified that full cost was intended to relate resources to outputs regardless of the funding source:

The full cost of a responsibility segment's output is the total amount of resources used to produce the output. This includes direct and indirect costs that contribute to the output, regardless of funding sources. It also includes costs of supporting services provided by other responsibility segments or entities. (SFFAS 4, par. 89)

6. Ultimately, attaining full cost is critical to improving performance measurement. SFFAS 4 states:

Measuring performance is a means of improving program efficiency, effectiveness, and program results. One of the stated purposes of the GPRA of 1993 is to “. . .improve the confidence of the American people in the capability of the federal government, by systematically holding federal agencies accountable for achieving program results.” (SFFAS 4, par. 34)

Measuring costs is an integral part of measuring performance in terms of efficiency and cost-effectiveness. Efficiency is measured by relating outputs to inputs. It is often expressed by the cost per unit of output. While effectiveness in itself is measured by the outcome or the degree to which a predetermined objective is met, it is commonly combined with cost information to show “cost-effectiveness.” Thus, the service efforts and accomplishments of a government entity can be evaluated with the following measures:

(1) Measures of service efforts which include the costs of resources used to provide the services and non-financial measures;

(2) Measures of accomplishments which are outputs (the quantity of services provided) and outcomes (the results of those services); and

(3) Measures that relate efforts to accomplishments, such as cost per unit of output or cost-effectiveness. (SFFAS 4, par. 35, emphasis added)

Thus, ..., performance measurement requires both financial and non-financial measures. **Cost is a necessary element for performance measurement, but is not the only element.** (SFFAS 4, par. 36, emphasis added)

7. This standard establishes a date certain—reporting periods beginning after September 30, 2008—for full cost accounting by federal reporting entities. This standard affords time to provide needed guidance before the effective date. The Board anticipates the release of one or more Technical Releases that will address implementation issues during this time. Entities may also use the time period between the issuance of this standard and the actual effective date to establish reimbursable agreements, seek implementation guidance on specific issues if necessary, and develop internal guidance on recognizing inter-entity costs.

**Standards of
Federal Financial
Accounting**

Amendments to SFFAS 4 **Amendments to Existing Standards**

8. Statement of Federal Financial Accounting Standard (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts*, Inter-Entity Costing, par. 110 is rescinded.
9. The sentence “Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above” is rescinded from par. 111 of SFFAS 4.

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- Effective Date** 10. This standard is effective for reporting periods beginning after September 30, 2008. Earlier implementation is encouraged.

The provision of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement—not the material in this appendix—should govern the accounting for specific transactions, events or conditions.

Introduction

11. The inter-entity cost provision in SFFAS 4 provided that each entity's full cost should incorporate the full cost of goods and services that it receives from other entities. However, SFFAS 4 provided for gradual implementation of the inter-entity cost provision.

12. In 1995, the Board provided implementation guidance stating:

Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget [OMB], with assistance from the FASAB staff, should **identify the specific inter-entity costs** for entities to begin recognizing. OMB should then issue guidance identifying these costs. **These particular inter-entity costs should be specified in accordance with this standard including the recognition criteria presented below.** The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards. (SFFAS 4, par. 110, emphasis added)

13. OMB requested that the AAPC provide assistance in developing the guidance anticipated by SFFAS 4, par. 110. The AAPC inter-entity cost task force was formed and initial research was conducted beginning in July 2000. The task force, chaired by James Taylor, Deputy Chief Financial Officer of the Department of Commerce, reported the task force research findings and recommendations to the AAPC at its May 2003 meeting. The task force report is available on the AAPC website at <http://www.fasab.gov/aapc/iecs.html>.

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14. The task force recommended no changes to the current limitations on application of SFFAS 4 inter-entity costs provisions. The task force found:

The current implementation guidance (limitation on recognizing inter-entity costs) is an impediment to progress towards full costing.

While there likely is under-recognition of costs, government-wide guidance for any individual cases is not warranted.

Full costing should be accomplished by encouraging reimbursable agreements.

15. Before implementation of any revision or removal of the limitation on recognition of inter-entity costs, the task force believed that:

a. There should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. For example, guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued.

b. There should be established policies and procedures for the providing agency to submit necessary data to the receiving agency (for the receiving agency's evaluation and/or calculation of inter-entity costs). A particular concern is the "providing" agencies' ability and/or willingness to provide the "receiving" agency with needed data, and the availability to the receiving agency of alternate data when the providing agency cannot or will not provide data to the receiving entity.

c. There should be adequate consultation among Federal agencies and the Federal audit community about the revision or removal of the OMB restriction prior to implementation.

16. The Board appreciates the considerable talents and time volunteered by the AAPC task force. The findings and recommendations of the task force suggest that the gradual implementation planned for SFFAS 4's inter-entity cost provisions is or will be unnecessary with time due to reimbursable agreements. The task force found that inter-entity costs are increasingly being reimbursed at full cost. Further, the task force

believes that entities should continue to increase the use of full-cost reimbursable agreements. With these actions, the task force believes the need for implementation guidance would be minimized because costs would be captured based on transactions.

17. While federal entities may continue to pursue reimbursable agreements, the Board does not wish to rely solely on that mechanism. The Board does not believe the existence of reimbursable agreements for all material⁴ inter-entity costs at a point in time would be a permanent resolution of the issue. In addition, because there is no guarantee that reimbursable agreements would be universally obtainable and consistently pursued over time, the barrier to full implementation currently provided in SFFAS 4 must be removed. The Board believes that establishing a date for the removal of the barrier is appropriate.
18. The Board believes the task force's proposal would (1) defer action to an unspecified time and (2) still require future action by FASAB to remove the barrier to full implementation of the inter-entity cost to ensure full costing is implemented over time.
19. Since SFFAS 4 – excluding the inter-entity cost provisions – was effective in fiscal year 1998 and the implementation guidance has not progressed, the Board believes establishing a date certain for full implementation is appropriate. The task force expressed concerns regarding competing priorities for scarce resources and inter-entity cost implementation should not begin at this time. Therefore, the implementation date of this standard is sufficiently distant to alleviate the concerns expressed by the task force.
20. The Board believes that establishing a date certain for implementation of the inter-entity cost provisions of SFFAS 4 would be a more effective and permanent resolution of the issue. Acting soon after the task force's surveys would ensure that deferral of action does not result in a need for further surveys or for future action by the Board to remove the barrier. In addition, this standard affords time to provide needed guidance (See Additional Guidance below).

⁴ SFFAS 4 addresses materiality at length in par. 112 and 113. Nothing in this standard or the AAPC task force report alters that guidance. Therefore, terms such as "materiality" and "significance" should be evaluated in the context established by SFFAS 4, par. 112 and 113.

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21. This standard balances the concerns raised by the task force regarding current priorities and resource constraints, and the goals of SFFAS 4. This standard establishes a date certain for full cost accounting by federal reporting entities. Further, by permitting early implementation entities would be afforded the opportunity to improve full cost recognition sooner. For those entities receiving material amounts of non-reimbursed or under-reimbursed inter-entity goods and services, full implementation would enhance the completeness and comparability of cost information.
22. In addition, this standard is consistent with the initial steps taken by the Board in Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* and resolves concerns expressed by respondents to the exposure draft leading to Interpretation 6. Interpretation 6, issued in April 2003 and effective for periods beginning after September 30, 2004, requires recognition of intra-departmental inter-entity costs. Some respondents to the exposure draft leading to Interpretation 6 expressed concern regarding the inconsistent treatment of inter- and intra-departmental inter-entity costs. The Board then concluded that a gradual reduction of the un-recognized inter-entity costs would be preferable to no action. In addition, the Board opined that the experience gained with respect to intra-departmental inter-entity costs would be useful in addressing inter-departmental inter-entity costs. (See par. 42 of Interpretation 6.)
23. The Board believes that this standard is essential to attaining the full cost accounting envisioned in SFFAS 4. Further, full cost information is essential to effective performance measurement.

Amendments to Standards

24. To require full implementation of the inter-entity cost provision, this standard amends SFFAS 4, *Managerial Cost Accounting Standards and Concepts* by
- Rescinding Inter-Entity Costing, par. 110; and
 - Rescinding the sentence “Such recognition, however, should be made in accordance with the implementation guidance issued by OMB as discussed above” from par. 111.

Exposure Draft

25. FASAB published the exposure draft (ED) *Inter-Entity Cost Implementation Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts* on April 26, 2004. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, and the *Government Accounting and Auditing Update*; the CFO Council, the Presidents Council on Integrity and Efficiency, the Financial Statement Audit Network, the Federal Financial Managers Council; and committees of professional associations generally commenting on exposure drafts in the past.
26. 21 letters were received from the following sources:

	FEDERAL (internal)	NONFEDERAL (external)
Users, academics, others		3
Auditors	2	2
Preparers and financial managers	14	

27. A public hearing was held on December 16, 2004. Individuals from the Library of Congress, Department of Interior, and a representative from the Association of Government Accountants Financial Management Standards Board testified at the public hearing.

Responses to the ED

28. Approximately one-half of the respondents agreed with the Board's proposal that the inter-entity cost provisions of SFFAS 4 should be fully implemented. In other words, approximately one-half of the respondents disagreed with the Board's proposal and agreed with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis.
29. Approximately one-half of the respondents believed that there were non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS 4. Additionally, a majority of respondents believed that federal entities would seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.

30. Approximately one-half of the respondents believed that additional guidance was needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity and that additional guidance was needed to apply the broad and general support exception.

Board Consideration of
Comments

31. The Board determined the main concerns identified by respondents included (1) the lack of implementation guidance and (2) costs would not be recognized consistently across agencies.
32. The Board noted that the task force acknowledged that restricting the recognition of inter-entity costs is an impediment to full costing. In addition, the task force did not find material non-reimbursed or under-reimbursed inter-entity costs for which government-wide guidance was warranted. However, the task force did note that some costs could be material for selected agencies. This finding would be consistent with the comment letters to the ED, as approximately one-half of the respondents did believe that material non-reimbursed or under-reimbursed inter-entity costs that meet the recognition criteria do exist.
33. The task force reported that there should be detailed, practical guidance (beyond SFFAS 4 guidance) available to agencies on identifying, quantifying, and evaluating inter-entity costs, particularly evaluating the inter-entity costs' significance and materiality. The task force reported that guidance could include case studies and examples, and a list of examples of inter-entity costs could be issued. It also reported that there should be established policies and procedures for the providing agency to submit necessary data to the receiving agency (for the receiving agency's evaluation and/or calculation of inter-entity costs). The comment letters to the ED supported the task force recommendations regarding the need for guidance.
34. Therefore, the Board determined that there was a need for additional guidance. The Board believes that with the issuance of additional detailed, practical guidance, agencies will have the tools necessary to implement inter-entity full costing and capture the costs that potentially exist. (See Additional Guidance below.)
35. Several respondents indicated that costs would not be recognized consistently across agencies as reliance on entity's judgment in

identifying costs will result in differing interpretations. The Board expects differences will occur as agencies analyze their particular potential inter-entity cost against the recognition criteria because it is likely that certain costs may be material to one agency and not to another agency. This would appropriately occur considering materiality and the recognition criteria. The Board believes such expected differences are likely to occur but should not prevent agencies from informing financial statement users of material costs incurred.

36. Additionally, the Board reiterates that the recognition criteria in par. 112-113 of SFFAS 4 (which provides general criteria to determine which costs should be recognized) apply. The accounting and reporting for inter-entity costs that are recognized should be consistent and in accordance with par. 108-109 and 114-115 of SFFAS 4, which provide specific accounting examples.

Additional Guidance

37. As discussed above, the Board determined that there was a need for additional guidance. Therefore, the task force has been requested to continue its work in this area by developing one or more Technical Releases (TR) that will address implementation issues raised by respondents. The Board has also suggested certain operational guidance be issued by the Office of Management and Budget (OMB). It should be noted that the guidance does offer a venue for agencies to direct agency-specific questions.
38. The Board believes that the task force could build upon their already extensive survey results and research, as well as the comment letters and staff analysis in developing the guidance. Specifically, the task force work may include an extensive evaluation of costs to determine which ones may be considered “Broad and General” for all entities and if possible, a list of the costs that should be considered Broad and General for all entities would be included in the TR. The TR may also include additional guidance or discussion on the factors *Directness of relationship to the entity’s operations* and *Identifiability* as used in determining if a transaction should be considered material to the receiving entity.⁵

⁵ See SFFAS 4 par. 111-113 for recognition criteria

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39. It is also anticipated that the task force will collect individual inter-entity requests for guidance on specific cases and determine if general guidance in the area can be provided on the issue, and if so, the TR will provide such clarifying guidance. The actual cases will be forwarded to OMB with the task force's recommendation, which will reference the general guidance in the TR. However, final disposition of the individual entity-specific cases will be determined by OMB.
40. The task force could utilize existing guidance related to cost accounting in developing the guidance. Specifically, the CFO Council's Cost Accounting Implementation Guide and the Joint Financial Management Improvement Program's System Requirements for Managerial Cost Accounting, among others, are good sources of information.
41. Additionally, the task force may wish to solicit volunteers from the agencies that provided comments to the ED for assistance. Also, volunteers could be requested from agencies that successfully implement Interpretation Number 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* considering the effective date for this was for periods beginning after September 30, 2004.

Effective Date

42. The proposed effective date in the ED was for periods beginning after September 30, 2007. The Board determined that the effective date of this standard should be delayed to periods beginning after September 30, 2008. The Board delayed the implementation date to allow the AAPC and OMB to develop the additional guidance detailed above.

Board Approval and Dissent

43. This Statement was approved for issuance by eight members of the Board. Mr. Reid dissented. Mr. Anania abstained.
44. Mr. Reid dissents from this Statement because he opposes rescinding paragraph 110. He believes that the inter-entity cost provisions should be implemented on a step-by-step basis. Mr. Reid notes that the basis for conclusions of SFFAS 4 states that the Board has expressed the need to take a measured, step-by-step, practical approach to implementing the inter-departmental costing standard. He notes that it further explains that the Board recommended that 1) OMB, with assistance from the FASAB staff, should identify those specific inter-

departmental, un-reimbursed or under-reimbursed costs that entities should recognize, and 2) OMB should then issue guidance describing those costs. The Board anticipated that the largest and most important inter-departmental costs would be identified first; then other costs would be identified as entities gained experience in the application of the standard. Mr. Reid believes this approach was seen as a practical way to ensure uniformity in the application and implementation of the standard and to allow time and experience for overcoming any other practical problems which arose.

45. Mr. Reid believes that a better way to proceed is found in the procedure set forth in SFFAS 4 for identifying costs to be recognized. He believes that SFFAS 4 never contemplated the discontinuance of the procedure but rather held that specific costs would continue to be identified. Mr. Reid believes it is a far different approach to open the door to all costs. He believes rescinding paragraph 110 of SFFAS 4 defeats the idea set forth in SFFAS 4 that the standard be consistently applied and implemented.
46. Mr. Reid believes that the notion of consistent application is still a valid concern. He noted that when charged with identifying other costs to be imputed the Accounting and Auditing Policy Committee task force could not suggest additional costs to be recognized that were government-wide in nature and met the criteria of SFFAS 4. He believes that opening the door to recognition of inter-departmental costs that are not government-wide in nature is a new approach since such costs, identified on a case-by-case basis, cannot be applied consistently government-wide. Mr. Reid believes that control over the implementation of the standard will be lost and uncertainty will result.
47. Mr. Reid believes that if FASAB is dissatisfied with progress being made to identify additional costs, FASAB itself should identify specific costs to be recognized. SFFAS 4 indicates that FASAB may do this. Such action by FASAB would be compatible with the consistency notion and would not result in loss of control or uncertainty.
48. Mr. Reid believes that losing control over the recognition of inter-departmental costs will result in considerable activity with little or no value as agencies try to comply with a standard open to different interpretations by the preparer and the auditor. This change will expose agencies to possible challenges by auditors over unknown or immaterial costs, that cannot be determined with any certainty. In

addition uncontrolled cost imputation will add significantly to the difficulties of eliminating these costs in consolidation.

49. He also believes that this standard will result in uncontrolled imputation of inter-departmental costs and may instigate an iterative process of charges and charge-backs. These multiple rounds of cost imputation will provide little benefit and make it difficult for agencies to close their books quickly. Mr. Reid believes that as agencies impute costs from others, their costs will increase thereby increasing the costs others would need to impute from them. He believes this will create multiple rounds of cost imputation which will provide little benefit and will not be useful for agency decision making as it relates to costing of programs.
50. Mr. Reid believes this standard is a departure from the ideas of SFFAS 4 as they relate to the standard on inter-departmental cost recognition. He is not opposed to recognizing additional specific costs, but is opposed to doing so in an uncontrolled fashion.

Interpretation of Federal Financial Accounting Standards 1: Reporting on Indian Trust Funds in General Purpose Financial Reports of the Department of the Interior and in the Consolidated Financial Statements of the United States Government: An Interpretation of SFFAS 7

Status

Issued	March 12, 1997
Effective Date	For fiscal periods beginning after September 30, 1997
Volume II References	
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

The assets, liabilities and operating transactions of the Indian trust funds are not part of the Department of Interior and should not be included in the balance sheet, statement of net cost, and statement of changes in financial position of the Department or of the United States Government. However, the Department does have a fiduciary responsibility for these funds and is required to report on them in footnotes.

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Introduction

1. The Department of the Interior requested guidance about how to report information on Indian trust funds in the general purpose financial report of the Department. The Indian trust funds are managed by Interior's Office of Special Trustee, Office of the Secretary. (Prior to FY 1996 the trust funds were managed by the Bureau of Indian Affairs.) Some of the funds belong to individual Indians, others belong to tribes. The funds are managed by the federal government in a trust arrangement. While the Government's responsibility for all of these funds is of a fiduciary nature, some portion of the annual flows for some of the funds have been included in the *Budget of the United States Government*. (Further discussion regarding types of funds involved is provided on page 1143.)
2. According to SFFAC 2, *Entity and Display*, inclusion of a program in the section of the budget currently entitled "Federal Programs by Agency and Account" is conclusive evidence that the program should be part of the reporting entity. The question thus arises whether the assets and activities of the Indian trust funds should be reported in the Department of Interior's general purpose financial statements. Also, SFFAS 7, *Accounting for Revenue and Other Financing Sources*, requires certain disclosures regarding "dedicated collections," including fiduciary funds. During discussion of this issue at the FASAB, questions arose about what type of disclosures should be provided regarding the Indian trust funds.

Interpretation

3. The assets, liabilities and operating transactions of the Indian trust funds are not part of the Department of Interior and should not be included in the balance sheet, statement of net cost, and statement of changes in financial position of the Department or of the United States Government. However, the Department does have a fiduciary responsibility for these funds and is required to report on them in footnotes to the financial statements by SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraphs 83-87.

Scope Of Interpretation

4. This Interpretation deals with what information about Indian trust funds should be included in the general purpose financial report of the Department of Interior and of the United State Government. It does not address issues regarding (1) reporting formats for the footnote disclosure required by SFFAS 7, (2) inclusion or exclusion of other

Interpretation 1

fiduciary funds as components of the federal reporting entity, (3) inclusion or exclusion of any funds or entities in the *Budget of the United States Government*, or (4) reporting on other funds labeled “trust funds” in the federal budget, reporting for trust funds, or reporting on deposit funds generally.¹

Effective Date

5. The interpretation is effective upon implementation of SFFAS 7, which is effective for reporting periods that begin after September 30, 1997. Earlier application of SFFAS 7 is encouraged.

¹This restriction on the scope of this interpretation does not imply that this treatment would be inappropriate for other fiduciary funds. Other funds were not included in the research supporting this Interpretation and are therefore excluded.

Appendix: Basis For Conclusions

Entity Criteria

6. In its discussion of the budgetary perspective, SFFAC 2 notes:

18. Care must be taken in determining the nature of all trust funds and their relationship to the entity responsible for them. A few trust funds are truly fiduciary in nature. Most trust funds included in the budget are not of a fiduciary nature and are used in federal financing in a way that differs from the common understanding of trust funds outside the federal government. In many ways, these trust funds can be similar to revolving or special funds in that their spending is financed by earmarked collections.

19. In customary usage, the term “trust fund” refers to money belonging to one party and held “in trust” by another party operating as a fiduciary. The money in a trust must be used in accordance with the trust’s terms, which the trustee cannot unilaterally modify, and is maintained separately and not commingled with the trustee’s own funds. This is not the case for most federal funds that are included in the budget—the fiduciary relationship usually does not exist. The beneficiaries do not own the funds and the terms in the law that created the trust fund can be unilaterally altered by Congress.

7. Indian trust funds are “true” trust funds in the customary sense, in which there is a legal fiduciary relationship between the Government as trustee and the Indians as trustor. The Government does not own the assets of the funds. In some cases the Government’s trustee relationship is with individuals, in other cases with tribes. For many of the funds involved, a tribe or individual can use the funds or dissolve the trust at any time; however, there is a restriction on the use of funds that have been received through legal judgments. Those funds are generally not available until the beneficiaries agree how the funds are to be distributed among them.

8. The budget treats the two types of Indian trust funds differently. Tribal funds are included in the budget. Individuals’ funds are not in the budget; they are treated as deposit funds. The Indian tribal trust funds appear to meet *Entity and Display’s* conclusive criterion because of their budgetary treatment. The question regarding these funds is whether this implies that these funds should be reported on the face of Interior’s financial statements, with the assets, liabilities, revenues and expenses of the Department.

9. Another question arises regarding the Indian trust funds that do not appear to meet the conclusive criterion: would they meet the indicative criteria? The Department of the Interior interprets the indicative criteria in paragraph 44 of SFFAC 2 to mean that the Indian trust funds do not possess any of these characteristics.
10. Some people believe that the sixth indicative criterion does, in fact, apply: “. . . a fiduciary relationship with a reporting entity . . .” However, they believe that meeting any single indicative criterion is not necessarily sufficient to define the Indian trust funds as part of a reporting entity. *Entity and Display* cautioned expressly that “no single indicative criterion is a conclusive criterion.”
11. Other people do not believe that even this indicative criterion applies. They believe that, notwithstanding the use of this terminology, the relationship discussed in the sixth indicative criterion concerns factors relating to committing the component entity financially, controlling the collection and disbursement of funds, or having financial interdependence. They believe that this type of financial control and interdependence does not exist between the Indian trust funds and the federal government.
12. While the Indian tribal funds might appear to meet the criteria for inclusion as a component of the federal reporting entity (by virtue of the budgetary criterion if no other), the sovereignty of the Indian tribes as entities outside the federal government, and the fiduciary relationship between the Government and the Indians, indicate that the criteria stated in *Entity and Display* should not be interpreted to suggest that the assets, liabilities, revenues and expenses of these fiduciary funds should be reported on the face of Interior’s financial statements.
13. *Entity and Display’s* discussion of the budget perspective cautions that, when defining a reporting entity, care must be taken in determining the nature of all trust funds and their relationship to the entity responsible for them (SFFAC 2, para. 18). This provides some common sense advice relevant to the Indian trust funds.

Disclosures For
Dedicated Collections

14. As noted, the disclosure requirements for dedicated collections in SFFAS 7, para. 83-87, are applicable to the Indian trust funds. The Department of Interior should include this information in footnotes to

its basic financial statements. In addressing the comments received on the exposure draft leading to Statement 7, the Board specifically noted that:

226.1 The proposed standard did not cover funds administered by a federal entity in a fiduciary relationship with beneficiaries that were not included in the entity's financial statement. In addition, it did not cover other funds which are of the same nature as many trust funds. The standard now requires disclosures for these funds also.

Interpretation of Federal Financial Accounting Standards 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5

Status

Issued	March 12, 1997
Effective Date	For fiscal periods beginning after September 30, 1996
Volume II References	Managerial Cost Accounting (M20), Liabilities (L40)
Interpretations and Technical Releases	TR No. 1, <i>Audit Legal Representation Letter Guidance</i>
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 12 affects Interpretation 2 paragraphs 3 and 8 by changing the recognition criteria for liabilities arising from litigation.

Summary

The Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is probable and estimable, the entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source" amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss.

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Introduction

1. The Federal Accounting Standards Advisory Board (FASAB) has been asked to clarify Federal accounting standards as they relate to the Treasury Judgment Fund. The Treasury Judgment Fund was established by Congress in the 1950's to pay in whole or in part the court judgments and settlement agreements negotiated by the Justice Department on behalf of agencies, as well as certain types of administrative awards. The Congress established the Judgment Fund as a permanent, indefinite appropriation.
2. The clarification addresses (1) how Federal entities should report the costs and liabilities arising from claims to be paid by the Treasury Judgment Fund and (2) how the Judgment Fund should account for the amounts that it is required to pay on behalf of Federal entities. This interpretation has been prepared on the basis of the following three accounting Standards:
 - Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*
 - Statement of Federal Financial Accounting Standards Number 5, *Accounting for Liabilities of the Federal Government*
 - Statement of Federal Financial Accounting Standards Number 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

The provisions of this interpretation need not be applied to immaterial items.

Interpretation

Accounting by the Federal Entity

3. SFFAS No. 5 states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is **probable**; and the future outflow or sacrifice of resources is measurable. The Federal entity's management, as advised by the Justice Department, must determine whether it is **probable** that a legal claim will end in a loss for the Federal entity and the loss is estimable. If the loss is **probable** and estimable, the entity would recognize an expense and liability for the

full amount of the expected loss¹. The expense and liability would be adjusted periodically, as necessary, based on any changes in the estimated loss. The Federal entity involved in the litigations shall discuss in a footnote to the financial statements the Judgment Fund's role in the payment of a possible loss.

4. Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for the payment of the claim, the liability should be removed from the financial statements of the entity that incurred the liability and an "other financing source"² amount (which represents the amount to be paid by the Judgment Fund) would be recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would reflect only that amount to be paid by the Judgment Fund on behalf of the Federal entity.

Accounting by the Treasury Judgment Fund

5. Once the claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment of the claim, the Judgment Fund would recognize an expense and an accounts payable or a cash outlay for the full cost of the loss. According to SFFAS 4, the imputed financing source amount recognized by the Federal entity and the expense recognized by the Judgment Fund would be eliminated at the Federal consolidated financial report level.

Effective Date

6. This interpretation is effective upon implementation of SFFAS 4 & 5, which become effective for fiscal periods beginning after September 30, 1996.

¹See paragraph 39 in SFFAS #5 for the complete discussion on "Estimating Contingent Liabilities."

²See paragraph 73 in SFFAS #7 for the complete discussion on "Financing Imputed for Cost Subsidies."

Appendix A: Basis For Conclusions

7. This interpretation is primarily based on the principles of SFFAS 5 and SFFAS 4. The following brief discussion explains the basis for the interpretation in terms of those standards which are the foundation for the interpretation.
8. In accordance with the general principles of the liability standard (SFFAS 5), once a legal claim is filed against a Federal entity, the entity's management should determine the likelihood that the Federal entity will incur a loss related to the claim³, regardless of the fact that the payment may be paid in full or in part by the Judgment Fund. The contingencies⁴ section of SFFAS 5 states that if the likelihood of the contingent loss is remote no reporting is necessary; if the likelihood of the loss is reasonably possible and the amount is measurable the estimated loss should be disclosed; and, **if the likelihood of loss is probable (more likely than not which is a greater than 50% chance of occurrence)** and estimable, the estimated loss must be recognized as a liability. If the probability of the loss is changed at any time prior to payment of the claim, the proper adjustments should be recognized [e.g., from disclosure (reasonably possible) to recognition (**probable**)]. If at any time the estimated loss amount changes, the liability and expense should be adjusted to reflect the change.⁵
9. In accordance with the principles of SFFAS 4⁶, a Federal entity incurring a loss or expense must recognize the full cost of the loss [claim], regardless of who is actually paying the [settlement or judgment] amount. The standard requires the Federal entity incurring a loss or expense to use an estimate of the cost if the actual cost information is not provided. The estimate must be reasonable and should be aimed at determining realistic losses expected.

³In most cases this determination involves the U.S. Department of Justice.

⁴A contingency is an existing condition, situation or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain or loss.

⁵See paragraphs 35 - 42 in SFFAS # 5 for the complete discussion on "Contingencies."

⁶See paragraphs 89 - 104 and 105 - 115 in SFFAS #4 for the complete discussion on "Full Cost" and "Inter-entity Costs", respectively.

Appendix B: Illustrative Journal Entries

Based on the above noted accounting standards and the generalized events described below, the conceptual journal entries⁷ should be as follows:

Federal entity entries:

The Federal entity's management, through the advisement of the Justice Department, has determined that the probability of the legal claim ending in a loss against the Federal entity is probable and the loss is estimable. The entity would recognize an expense and liability for the full amount of the expected loss. The expense and liability would be adjusted as necessary based on any changes in the estimated loss.

Entry #1:

DR. Expense
CR. Liability—Legal claims

Once the claim is either settled or a court judgment is assessed against the Federal entity and the Judgment Fund is determined to be the appropriate source for payment of the claim, the liability should be removed and an other financing source recognized. If the Judgment Fund is responsible for only a portion of the claim or settlement, the imputed financing source amount would only reflect that amount paid by the Judgment Fund on behalf of the Federal entity.

Entry #2:

DR. Liability—Legal claims
CR. Imputed Financing Source—Expenses Paid by Other Entities*

Treasury Judgment Fund entries:

The claim is either settled or a court judgment is assessed and the Judgment Fund is determined to be the appropriate source for payment.

⁷Actual journal entries are under the authority of the Standard General Ledger.

Interpretation 2

Entry #3:

DR. Expenses Paid for Other Entities*
CR. Cash or Fund Balance with Treasury

*According to the Cost Accounting Standard, the imputed financing source and expenses paid for other entities amounts would be eliminated at the consolidation level.

Interpretation of Federal Financial Accounting Standards 3: Measurement Date for Pension and Retirement Health Care Liabilities

Status

Issued	August 29, 1997
Effective Date	For fiscal periods beginning on or after September 30, 1997
Volume II References	Liabilities (L40), Pension, Other Retirement Benefits and Other Post-Employment Benefits(P20)
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

Pension and retirement health care liabilities in general purpose federal financial reports prepared pursuant to SFFAS 5 shall be measured as of the end of the fiscal year (or other reporting period if applicable). This measurement shall be performed following the end of the period reported, but does not have to be based on a full actuarial valuation as of the end of the reporting period. The measurement shall, however, reflect the best available estimates of the major factors that would be reflected in a full actuarial valuation. This measurement may be based on an actuarial valuation performed as of an earlier date during the fiscal year, including a beginning-of-year actuarial valuation, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise, cost of living adjustment, etc.

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Introduction

1. The Federal Accounting Standards Advisory Board (FASAB) was asked to endorse use of an actuarial valuation as of the beginning of the fiscal year to measure the pension and retirement health care liabilities in general purpose financial reports prepared pursuant to Statement of Federal Financial Accounting Standards Number 5 (SFFAS 5). This has been the practice in some of the special purpose financial reports on pension plans that are prepared pursuant to Public Law 95-595. OMB and GAO issue instructions for preparing the reports required by PL 95-595.
2. The plan reports called for by PL 95-595 receive scrutiny from congressional staff. Based on past experience, some actuaries were concerned that differences between actuarial measurements used in different reports would cause problems and confusion. Some people who support using a beginning-of-year valuation also were concerned about the potential for disagreements between auditors and preparers if projections or estimates were used instead of a full actuarial valuation. Other people, on the other hand, believed that measurements for recognizing liabilities in financial statements prepared pursuant to SFFAS 5 should be as of the end of the reporting period, and that a measurement based on a projection or “roll forward” of a full actuarial valuation would be appropriate if it were not feasible to perform a full actuarial valuation as of year end.

Interpretation

3. Pension and retirement health care liabilities in general purpose federal financial reports prepared pursuant to SFFAS 5 shall be measured as of the end of the fiscal year (or other reporting period if applicable). This measurement shall be performed following the end of the period reported, but does not have to be based on a full actuarial valuation as of the end of the reporting period. The measurement shall, however, reflect the best available estimates of the major factors that would be reflected in a full actuarial valuation, such as the actual pay raise, the actual cost of living adjustment, and material known changes in the number of employees covered (enrollment) that cause a change in the liability.
4. This measurement may be based on an actuarial valuation performed as of an earlier date during the fiscal year, including a beginning-of-year actuarial valuation, with suitable adjustments for the effects of changes during the year in major factors such as the pay raise, cost of

living adjustment, etc. This is sometimes referred to as a measurement based on a “projection” or “roll-forward” of the most recent available actuarial valuation. In evaluating the effect on the liability caused by changes in enrollment for plans that cover employees of more than one reporting entity (e.g., CSRS, FERS), materiality shall be assessed at the plan level. In evaluating the effect on the liability caused by changes in enrollment for plans that cover employees of only one reporting entity (e.g., Coast Guard, Department of State), materiality shall be assessed at the reporting entity level.

Scope of Interpretation

5. This interpretation applies to pension and retirement health care liabilities recognized in accordance with SFFAS 5 in general purpose federal financial reports, such as financial statements prepared pursuant to the Chief Financial Officers Act of 1990, as amended. It does not apply to reports on pension plans pursuant to the requirements of PL 95-595.

Effective Date

6. This interpretation shall be applied for reporting periods that end on or after September 30, 1997. The FASAB has reviewed and agreed with this interpretation. After this interpretation is signed by the FASAB members who represent the Department of the Treasury, the Office of Management and Budget, and the General Accounting Office, it will be published by OMB and will be effective. [Note: see Foreword for explanation of new procedures to reflect SAS No. 91 and revised FASAB MOU]

Appendix: Basis For Conclusions

7. SFFAS 5 defines standards for recognition and measurement of pension and retirement health care liabilities, which are reported as of the balance sheet date. Although SFFAS 5 does not explicitly discuss the measurement date, its provisions implicitly call for measurement at year end. “Measurement” implies estimation based on the best available information at the time, but does not necessarily require a full actuarial “valuation” as that term is used by actuaries.
8. To avoid potential confusion, ambiguity, or conflict with auditors, some people would prefer to use a beginning-of-year valuation (which is permitted by private sector standards for plan reporting pursuant to SFAS 35), or at least would prefer to use beginning-of-year enrollment while updating the valuation for other changes during the year (e.g., interest rate assumptions, COLAs, salary increases), which generally are more significant.
9. The Board acknowledges that changes in enrollment during the year will rarely lead to a material change in the liability, and that such changes will therefore not be a factor in some years. Nevertheless, in those years when a material change in the liability does arise because of a change in enrollment during the year, that change should be reflected in the measurement. Conceptually there is no reason to treat enrollment differently from other factors used in the measurement. The Board also acknowledges that precise enrollment data may not be readily available soon after year end, when the measurement is to be performed. The Board does not believe that this should normally present a problem, however, because absolute precision regarding enrollment should not be necessary, given a reasonable definition of materiality.

Interpretation of Federal Financial Accounting Standards 4: Accounting for Pension Payments in Excess of Pension Expense

Status

Issued	December 19, 1997
Effective Date	For fiscal periods beginning on or after September 30, 1997
Volume II References	Liabilities (L40), Pension, Other Retirement Benefits and Other Post-Employment Benefits (P20)
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

Changes in normal costs due to re-estimates of demographic and economic assumptions should be accounted for by the administrative entity as a change in accounting estimate. The effect of the change should be recognized in current and future years.

When the employer entity's total payment for FERS and CSRS exceeds the related total pension expense as defined in SFFAS No. 5, the entity should account for the excess payment as a transfer-out. The entity should include the transfer-out when determining results of operations on its statement of changes in net position.

Any FERS-related payment that exceeds the FERS-related pension expense should be offset against any imputed financing resulting from a CSRS-related payment being less than CSRS-related pension expense in calculating the amount of the transfer out. Only when the total pension payment exceeds total pension expense would a transfer-out be recognized.

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Introduction

1. The Federal Accounting Standards Advisory Board (FASAB) was asked for guidance regarding accounting at the agency level for employer agencies' payments to the pension trust fund when they exceed pension expense (based on an allocation of the total service [or "normal"] cost¹ by the Office of Personnel Management). This is a situation that was not contemplated in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*.
2. The objective of SFFAS No. 5 (paras. 71-78) is to have employer entities recognize the annual cost of their employees' pensions (pension expense) as measured by the annual normal cost for their employees, less any amounts contributed by the employees (para. 74).
3. The employer entity payment rates for the two major civilian pension systems—the Federal Employees Retirement System (FERS) and the Civil Service Retirement System (CSRS)—are provided in law and are not the same. For FERS, the payment rate is the employer entity's normal cost less the amount contributed by its employees; for CSRS, the payment rate and the pension expense rate under SFFAS No. 5 theoretically would be the same, since both would be based on the same principle: that pension expense and employer payments to the pension trust fund equal normal cost less the employees' contribution. For most CSRS, employer payments to the pension trust fund are by law set at seven percent of salaries which is substantially less than normal costs and therefore also less than pension expense based on normal cost.
4. SFFAS No. 5 explicitly provides the accounting for a situation in which pension expense is more than employer payments to the pension trust fund. The difference between the pension expense and the payment to the plan is to be accounted for by the employer entity as imputed financing.
5. However, due to (1) planning and operational requirements of budgetary administration and (2) recent legislation, the employer

¹"Service cost" and/or "normal costs"—the terms are used synonymously in SFFAS No. 5—are defined in SFFAS No. 5 as that portion of the actuarial present value of pension plan benefits and expenses that is allocated to a valuation year by the actuarial cost method.

entity's FERS pension expense may be less than the FERS-related employer payments to the pension trust fund.

6. The pension expense rate used by civilian employer entities to calculate pension expense is supplied by the administrative entity — in the case of FERS and CSRS, the administrative entity is the Office of Personnel Management (OPM). OPM analyzes the demographic and economic assumptions periodically and recalculates normal costs (for both FERS and CSRS).² The recalculation was done during FY 1997 and resulted in a lower normal cost for both FERS and CSRS, and OPM has issued a revised FY 1997 pension expense rate based thereon. However, regarding the rate for employer payments to the pension trust fund, OPM allows time for employer entities to adopt the new rate for budgeting purposes during which the prior, higher payment rate will continue to be used by employer entities.
7. In addition, the Balanced Budget Act of 1997 (BBA) increases FERS employees' withholding rate from 1999 through 2001 without correspondingly decreasing the employer entity's payment rate. For example, if FERS normal costs were \$10,000 and the employees' contribution were raised from \$5,000 (as calculated absent BBA) to \$5,500 by the BBA, then the employer's expense according to SFFAS No. 5 should be \$4,500 (\$10,000 - \$5,500). However, the BBA does not allow the employer entity to reduce its payment, and therefore the employer pays what it would have paid without the BBA, \$5,000. The \$500 difference between the \$4,500 SFFAS No. 5 pension expense and the \$5,000 payment to the pension trust fund represents a payment in excess of pension expense.
8. For FY 1997, OPM has indicated that employer entities are unlikely to report total payments to the trust fund in excess of total pension expense (based on normal cost) at the entity-wide level, although it is possible, because the amount of the CSRS contribution deficiency is more than the excess FERS payment. However, OPM believes that it is probable that total payments will exceed total pension expense (based on normal cost less employee contributions) in future years.

²This is separate from OPM's annual recalculation of the actuarial liability which can result in actuarial gains and losses the accounting for which is provided in SFFAS No. 5.

Interpretation

9. ***Change in Estimate*** - Changes in normal costs due to re-estimates of demographic and economic assumptions should be accounted for by the administrative entity as a change in accounting estimate. The effect of the change should be recognized in current and future years.
10. ***Payments in Excess of Pension Expense*** - When the employer entity's total payment for FERS and CSRS exceeds the related total pension expense as defined in SFFAS No. 5, the entity should account for the excess payment as a transfer-out. The entity should include the transfer-out when determining results of operations on its statement of changes in net position.
11. Any FERS-related payment that exceeds the FERS-related pension expense should be offset against any imputed financing resulting from a CSRS-related payment being less than CSRS-related pension expense in calculating the amount of the transfer out. Only when the total pension payment exceeds total pension expense would a transfer-out be recognized.
12. Example #1:
 - i. if an employer entity calculates total pension expense as \$635,000 reflecting a FERS-related pension expense of \$535,000 and a CSRS-related pension expense of \$100,000,³ and
 - ii. it makes a total pension payment to the trust fund — excluding its employees' contribution — of \$630,000 reflecting \$570,000 for its FERS employees and \$60,000 for its CSRS employees,

³The amounts used for CSRS are from the example in SFFAS No. 5, paragraph No. 78.

- iii. then it would off-set the \$35,000 FERS-related excess payment (\$570,000 - \$535,000) against the \$40,000 CSRS-related under payment (\$100,000 - \$60,000) and recognize the net \$5,000 underpayment as an imputed financing as follows:

DR. Pension Expense (FERS \$535,000 + CSRS \$100,000)	635,000
CR. Funds with Treasury (FERS \$570,000 + CSRS \$60,000)	630,000
CR. Imputed Financing (\$40,000 - \$35,000)	5,000

13. Example #2: Assuming the same facts as in the paragraph immediately above except that the employer entity makes a payment of \$640,000 (\$580,000 FERS-related and \$60,000 CSRS-related) instead of \$630,000, then the entity would recognize a net transfer-out of the amount that the FERS-related excess payment (\$580,000 - \$535,000 = \$45,000) exceeded the CSRS-related under payment (\$100,000 - \$60,000 = \$40,000) as follows:

DR. Pension Expense (FERS \$535,000 + CSRS \$100,000)	635,000
DR. Transfer-out (\$45,000 - \$40,000)	5,000
CR. Funds with Treasury (FERS \$580,000 + CSRS \$60,000)	640,000

14. **Administrative Entity Intra-governmental Entries** - The administrative entity should account for funds received from employer entities in excess of the normal cost of pension expense as a transfer-in. The administrative entity should include the transfer-in when determining results of operations on its statement of changes in net position.
15. **Adjusting Entries** - Employer entities that recorded total FERS payments as pension expense during FY 1997 will need to adjust their accounts. The following examples use the amounts from paragraphs 12 and 13 above.

- a. Example #3 - if the entity had originally recorded the following pension expense based on an earlier provided normal cost rate:

DR. Pension Expense <i>(FERS \$570,000 + CSRS \$100,000)</i>	670,000	
<hr/>		
CR. Funds with Treasury <i>(FERS \$570,000 + CSRS \$60,000)</i>		630,000
<hr/>		
CR. Imputed Financing (CSRS)		40,000
<hr/>		

then, when the revised estimate is provided, the entry would recalculate pension expense as \$635,000 (FERS-related \$535,000 + CSRS-related \$100,000) and adjust the accounts accordingly by means of the following two simultaneous entries:

- (1) to reduce pension expense from \$670,000 to \$635,000 (FERS \$535,000 + CSRS \$100,000):

DR. Transfer-out	35,000	
<hr/>		
CR. Pension Expense		35,000
<hr/>		

- (2) to off-set the transfer-out against imputed financing:

DR. Imputed Financing	35,000	
<hr/>		
CR. Transfer-out		35,000
<hr/>		

These entries adjust the accounts to the amounts that would have been entered had the original entry reflected the revised normal cost as shown in paragraph 12 above.

- b. Example #4 - Also, if the entity's accounting resulted in a net transfer-out, an adjustment may be necessary. For example, using the illustration in paragraph 13 above, the entity may have

originally recorded pension expense based on an earlier provided normal cost rate as follows.

DR. Pension Expense <i>(FERS \$580,000 + CSRS \$100,000)</i>	680,000
CR. Imputed Financing <i>(CSRS)</i>	40,000
CR. Funds with Treasury <i>(FERS \$580,000 + CSRS \$60,000)</i>	640,000

then the adjustments would be the following two simultaneous entries:

- (1) to reduce pension expense from \$680,000 to \$635,000 (FERS \$535,000 + CSRS \$100,000):

DR. Transfer-out <i>(FERS \$580,000 - \$535,000 = \$45,000)</i>	45,000
CR. Pension Expense	45,000

- (2) to off-set the transfer-out against imputed financing:

DR. Imputed Financing <i>(CSRS)</i>	40,000
CR. Pension Expense	40,000

These entries adjust the accounts to the amounts that would have been entered had the original entry reflected the revised normal cost as shown in paragraph 13 above.

Scope of Interpretation

16. This interpretation applies to employer entity pension (and, if applicable, to retirement health care) expense, and to administrative entity's receipt of funds from employer entities, accounted for in accordance with SFFAS No. 5.

Effective Date

17. This interpretation should be applied for reporting periods that end on or after September 30, 1997. The FASAB has reviewed and agreed with this interpretation. After this interpretation is signed by the FASAB members who represent the Department of the Treasury, the Office of

Management and Budget, and the General Accounting Office, it will be published by OMB and will be effective.

Basis For Conclusions

18. Regarding changes in normal cost estimates, the prospective treatment called for in this interpretation reflects current practice, including APB Opinion No. 20, *Accounting for Changes in Accounting Estimate*, which provides that a change in accounting estimate should be accounted for in the period of change, if the change affects that period only, or in the period of change and future periods if the change affects both.
19. Regarding employer payments to the pension trust fund in excess of pension expense, such payments are not an employer entity expense or an administrative entity revenue. Such payments do not meet the definition of employer pension expense in SFFAS No. 5,⁴ as discussed above, nor do they meet the general definition of expense.⁵ The entity receiving the transfer—in this case an employer payment in excess of pension expense — does not sacrifice anything of value to obtain the payment, and the transferring entity does not acquire anything of value beyond what it would have gotten had it contributed an amount equalling normal cost less the employees' contribution. Thus, such payments meet the description of “transfer-out” provided in SFFAS No. 7.⁶

⁴SFFAS No. 5, para. 74.

⁵See Statements of Federal Financial Accounting Concepts and Standards, Original Statements, “Appendix E: Consolidated Glossary” on page 1371, wherein expenses are defined as:

outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period.

⁶For a description of transfers-in/out, see paragraphs 74 and 344 of SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

Interpretation of Federal Financial Accounting Standards 5: Recognition by Recipient Entities of Receivable Nonexchange Revenue: An Interpretation of SFFAS 7

Status

Issued	December 1998
Effective Date	Upon implementation of SFFAS 7, <i>Accounting for Revenue and Other Financing Sources of the Federal Government and Concepts for Reconciling Budgetary and Financial Accounting</i>
Volume II References	Receivable (R10), Revenue (R40)
Interpretations and Technical Releases	
Affects	None.
Affected by	None.

Summary

Entities that receive nonexchange revenue collected on their behalf by another entity should recognize the revenue based on the best available evidence at the time the financial report is prepared. This provision of paragraph 60 of SFFAS 7 is intended to require recognition of the excise tax “true up” of the difference between amounts transferred to trust funds based on estimates by Treasury’s Office of Tax Analysis and the actual amount subsequently determined by IRS. IRS certifies the third quarter actual amount in December. The intent of paragraph 60 is to recognize this “true up” amount as a receivable or payable. The Board did not intend to impose “push down” accounting that would require entities such as trust funds that receive boxes collected on their behalf to recognize a portion of IRS’s net taxes receivable.

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Introduction

1. Paragraph 60 of SFFAS 7, Accounting for Revenue and Other Financing Sources, requires entities that receive nonexchange revenue collected for them by other entities to recognize “. . . the net change in any related inter-entity balances between collecting and receiving entities.” The *Internal Revenue Service (IRS)* is the primary collecting entity for the United States Government, although Customs and other entities also collect substantial amounts of nonexchange revenue on behalf of the General Fund and other federal entities. Some of those involved with preparing and auditing IRS’s financial statements have asked whether this should be interpreted to require entities such as trust funds that receive taxes collected on their behalf to recognize a portion of IRS’s net taxes receivable. This is sometimes described as “push down” accounting. The Board did not intend to impose “push down” accounting, as is further explained by this interpretation.

Interpretation

2. Entities that receive nonexchange revenue collected on their behalf by another entity should recognize the revenue based on the best available evidence at the time the financial report is prepared. This provision of paragraph 60 of SFFAS 7 is intended to require recognition of the excise tax “true up” of the difference between amounts transferred to trust funds based on estimates by Treasury’s Office of Tax Analysis and the actual amount subsequently determined by IRS. IRS certifies the third quarter actual amount in December. The intent of paragraph 60 is to recognize this “true up” amount as a receivable or payable.¹

Effective Date

3. The interpretation is effective upon implementation of SFFAS 7.

¹Certification of the actual amount for the fourth quarter is not currently available from IRS until the end of March, which is too late to be included in the financial statements for the prior fiscal year.

Appendix: Basis For Conclusions

4. The Board understood, when it recommended the standards contained in SFFAS 7, that the information available to IRS and its information systems do not presently permit “push down” accounting as described above. It was not the Board’s intent to establish a standard in this regard that recipient entities could not comply with because of factors outside their control. The recognition, measurement, and disclosure standards in SFFAS 7 for collecting entities such as IRS were designed to provide for accountability and useful information regarding tax revenues from the collecting entities. Therefore, as noted above, this provision of SFFAS 7 is intended only to require recognition of the most recent available “true up” of the difference between amounts of nonexchange revenue transferred to recipient entities based on estimates by Treasury’s Office of Tax Analysis and the actual amount subsequently determined by IRS.
5. One Board member notes that it is not possible to accrue something that is not measurable. He believes that, if the fourth quarter is not measurable, no accrual can be made, and no interpretation is needed. If any entity can “true up” a given tax revenue number, that should be done. That is, it should report the best available information. From this perspective, the standard does not call for more than the best estimate that is possible for a given revenue. This member believes that if someone needs clarification, it should be provided, but the clarification need not be elevated to an interpretation.
6. The Board concluded that, because there is confusion, and because this issue could affect more than one entity, an interpretation would be appropriate to assure that the guidance is readily available to all who need it.

Interpretation 6, Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4

Status

Issued	April 18, 2003
Effective Date	for periods beginning after September 30, 2004
Volume II References	Managerial Cost Accounting (M20)
Interpretations and Technical Releases	None.
Affects	SFFAS 4, <i>Managerial Cost Accounting Standards and Concepts</i>
Affected by	<ul style="list-style-type: none">• SFFAS 30, Inter-Entity Cost Implementation. SFFAS 30 rescinds par. 110 of SFFAS 4, which is the par. that this Interpretation clarified. However, SFFAS 30 is not effective until periods beginning after September 30, 2008.

Summary

Par. 110 of SFFAS 4, states “Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget (OMB), with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs...”

Some of those involved with preparing and auditing financial statements for part of a department or larger reporting entity have asked whether par. 110 of SFFAS 4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, limits the recognition of imputed intra-departmental costs, i.e. costs between reporting entities that are part of the same department or larger reporting entity (other than the U.S. government as a whole).

This interpretation clarifies that par. 110 of SFFAS 4 does not limit the recognition of imputed intra-departmental costs. This interpretation further explains that reporting entities should account for imputed intra-departmental costs in accordance with the full cost provisions of SFFAS 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.

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Introduction

1. Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Standards and Concepts*, specifies that “each entity’s full cost should incorporate the full cost of goods and services that it receives from other entities.” (SFFAS No. 4, text box immediately preceding par. 105) SFFAS No. 4 refers broadly to the costs of goods and services provided between entities as “inter-entity costs.”
2. SFFAS No. 4 explains that for some inter-entity costs, the provider will be reimbursed by the recipient for the full cost. Therefore, the full cost of these inter-entity goods and services will be recognized in the recipient entity’s accounts through the normal recording of transactions. SFFAS No. 4 also specifies that inter-entity costs not fully reimbursed by the receiving entity should be recognized at full cost. To accomplish this recognition, the receiving entity should recognize an imputed financing source (SFFAS No. 4, par. 109 and SFFAS No. 7, par. 73) for the difference between the actual payment (if any) and the full cost. To facilitate discussion of the issue addressed in this interpretation, we will refer to costs that are not fully reimbursed as “imputed costs” whether or not recognized by the recipient.¹
3. Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display*, and SFFAS No. 4 use the term “inter-entity”; they do not use the terms “intra-departmental” and “inter-departmental.” To facilitate the understanding of the inter-departmental definition and relationship, this interpretation uses “department” to refer to any department, agency, administration or other financial reporting entity² that is not a part of a larger financial reporting entity other than the Government as a whole. Thus “department” in this context includes entities such as the General Services Administration, the National Science Foundation, and the Environmental Protection Agency, as well as executive branch departments such as Defense, Agriculture, Treasury, et al.

¹ Recognition of imputed costs is determined by accounting standards (see par. 14 and 30 of this interpretation for additional explanation.) General criteria to help in determining imputed costs that should be recognized are detailed in par. 112-113 and 239-243 of SFFAS No.4.

² Reporting entity as used in this interpretation refers to any entity that issues general purpose financial statements as discussed in par. 29 of *SFFAC No. 2, Entity and Display*.

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4. Activities between reporting entities that are not part of the same department or larger reporting entity other than the U.S. government as a whole are considered inter-departmental. Activities between reporting entities that are part of the same department or larger reporting entity (such as bureaus, components or responsibility segments within a department) are considered intra-departmental. Appendix B provides an illustration of inter-departmental and intra-departmental relationships.

Summary of Issue

5. Par. 110 of SFFAS No. 4, states “Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget (OMB), with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs...”
6. OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, Section 4.3, second par. states “Reporting entities are required to recognize the following costs...To ensure consistency, agencies should not recognize costs other than those listed until OMB provides further guidance.”
7. Some of those involved with preparing and auditing financial statements for part of a department or larger reporting entity have asked whether par. 110 of SFFAS No. 4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, limits the recognition of imputed intra-departmental costs, i.e. costs between reporting entities that are part of the same department or larger reporting entity (other than the U.S. government as a whole).
8. This interpretation clarifies that par. 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs. This interpretation further explains that reporting entities should account for imputed intra-departmental costs in accordance with the full cost provisions of SFFAS No. 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.

Interpretation

9. Although par. 110 of SFFAS No. 4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, does limit the recognition of inter-entity costs to those costs that OMB has identified for recognition, this limitation applies solely to imputed inter-departmental costs. Par. 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs.
10. **Imputed inter-departmental costs** are the unreimbursed (i.e. non-reimbursed and under-reimbursed) portion of the full costs of goods and services received by the entity from a providing entity that is not part of the same department or larger reporting entity other than the U.S. government as a whole.
11. **Imputed intra-departmental costs** are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, components or responsibility segments within the department or larger reporting entity).
12. Appendix B provides an illustration of inter-departmental and intra-departmental relationships.
13. Reporting entities should account for and recognize imputed intra-departmental costs in accordance with the full cost provisions of SFFAS No. 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.
14. The recognition criteria in par. 112-113 of SFFAS No. 4 (which provides general criteria to determine which costs should be recognized) apply to both imputed intra-departmental and inter-departmental costs. Accounting and reporting for imputed intra-departmental and inter-departmental costs that are recognized should be consistent and in accordance with par. 108-109 and 114-115 of SFFAS No. 4, which provide specific accounting examples.
15. Reporting entities should disclose on the face of the financials or in the notes to the financial statements, which are an integral part of the basic financial statements, both imputed intra-departmental and inter-departmental financing sources that are recognized.

Scope of Interpretation

16. This interpretation applies to imputed inter-entity costs accounted for in accordance with SFFAS No. 4. Specifically, this interpretation clarifies that par. 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs.

Effective Date

17. This interpretation is effective for periods beginning after September 30, 2004. Earlier implementation is encouraged.

The provisions of this Interpretation need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Interpretation. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

Summary of Issue

18. Par. 110 of SFFAS No. 4 states “Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget (OMB), with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs...”
19. OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, section 4.3, second par. states “Reporting entities are required to recognize the following costs...To ensure consistency, agencies should not recognize costs other than those listed until OMB provides further guidance.”
20. Some of those involved with preparing and auditing financial statements for part of a department or larger reporting entity have interpreted par. 110 of SFFAS No.4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, as limiting departmental management’s ability to recognize imputed costs among reporting entities within the department. This is not the Board’s intent.

Interpretation and Explanation, Including Definition of Terms

21. Although par. 110 of SFFAS No. 4, when considered in conjunction with section 4.3 of OMB Bulletin 01-09, does limit the recognition of inter-entity costs to those costs that OMB has identified for

recognition³, this limitation applies solely to imputed inter-departmental costs. Par. 110 of SFFAS No. 4 does not limit the recognition of imputed intra-departmental costs.

22. The limitation is necessary with respect to imputed inter-departmental costs, because government-wide guidance is necessary to assure that imputed inter-departmental costs are accounted for and recognized in a practical and consistent manner. This limitation is not necessary with respect to the recognition of imputed intra-departmental costs. Department management can define responsibility segments for a department, and it can determine and implement comparable and consistent cost accounting policy in accordance with SFFAS No. 4 within the department. It does not need external guidance to set policy or external authority to enforce it.
23. Imputed intra-departmental costs are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (ie. other bureaus, components or responsibility segments within the same department or larger reporting entity.) An example of an imputed intra-departmental cost would be within the Department of Justice, the Drug Enforcement Agency (DEA) may perform drug processing (lab testing, results, etc.) for the Federal Bureau of Investigation without reimbursement.
24. Imputed inter-departmental costs are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is not part of the same department or larger reporting entity other than the government as a whole. An example of an imputed inter-departmental cost would be for drug processing provided by

³ With respect to the limitations on recognition of imputed inter-departmental costs, par. 110 of SFFAS No. 4 indicates that OMB will provide guidance. Specifically, OMB Bulletin No. 01-09 provides such guidance and states the following costs should be recognized: (1) employees' pension, post-retirement health and life insurance benefits, (2) other post-employment benefits for retired, terminated, and inactive employees which includes unemployment and workers compensation under the Federal Employees' Compensation Act, and (3) losses in litigation proceedings. Currently, a task force of the Accounting and Auditing Policy Committee is identifying other potential inter-departmental costs for recognition and related guidance that should lead to consistency among departments recognizing inter-entity costs.

DEA to the U.S. Customs Service (which is not a part of the Department of Justice) without reimbursement.⁴

25. Appendix B provides an illustration of intra-departmental and inter-departmental relationships.
26. SFFAS No. 4 requires reporting entities to measure and report the full costs of their outputs (products and services) in general purpose financial reports. SFFAS No. 4 further defines the full cost of an output produced by a responsibility segment as the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, regardless of funding sources and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities.

27. SFFAS No. 4 par. 108 reads:

If an entity provides goods or services to another entity, regardless of whether full reimbursement is received, the providing entity should continue to recognize in its accounting records the full cost of those goods or services. The full costs of the goods or services provided should also be reported to the receiving entity by the providing entity.

28. Further support of the Board's intent is found in SFFAS No. 4's basis for conclusions. Specifically, par. 224-249, indicate that the Board considered the inter-entity issue as involving inter-departmental costs. In particular, footnote 50 in SFFAS No. 4, reads:

Full cost, as discussed in the full cost standard, contemplates both intra-entity costs and inter-entity costs applicable to a responsibility segment. This standard elaborates on inter-entity costs. Intra-entity costing is accomplished through the costing methodology selected for use within the reporting entity since these costs are passed among responsibility segments.

⁴Although the example is an imputed inter-departmental cost, current OMB guidance does not include this particular cost as one to be recognized. See footnote 3 for additional detail regarding the current OMB guidance and the project to identify other costs for recognition.

29. This indicates that the Board intended intra-departmental costs to be assigned, allocated, or imputed as determined by department management in accordance with the full cost standard. Reporting entities should account for intra-departmental costs in accordance with the full cost provisions of SFFAS No. 4. To account for the full cost of a program and its output(s), reporting entities should recognize imputed intra-departmental costs.

Accounting and
Implementation

30. The recognition criteria in par. 112-113 of SFFAS No. 4 apply to both imputed intra-departmental and inter-departmental costs. The standard explains that the determination of whether the cost of non-reimbursed or under-reimbursed goods and services should be recognized requires the use of judgment. Ultimately, the decision should be “based on the specific facts and circumstances of each case, with consideration of the degree to which inclusion or exclusion would change or influence the actions and decisions of reasonable persons relying on the information.” (SFFAS No. 4, par. 113)

31. Accounting and reporting for imputed intra-departmental and inter-departmental costs that are recognized should be consistent and in accordance with par. 108-109 and par.114-115 of SFFAS No. 4 which provide specific accounting examples. The standard requires that the receiving entity recognize the full cost of the goods or services that it receives. To the extent that reimbursement is less than full cost, the receiving entity should recognize the difference as a financing source.

32. Reporting entities should disclose both imputed intra-departmental and inter-departmental financing sources that are recognized. This will allow the readers of the financial statements to understand how much a reporting entity is subsidized by other reporting entities within the department or larger reporting entity, versus those outside of the department. Additionally, it would be of particular importance when the reporting entity is producing stand-alone financial statements, as the intra-departmental costs and financing sources would not be eliminated. However, intra-departmental costs and financing sources would be eliminated for any consolidated financial statement covering both reporting entities, which is consistent with par. 109 of SFFAS No. 4, but disclosure of such financing sources should be included in the notes to the financial statements. Par. 244-246 of SFFAS No. 4 provides additional discussion of consolidated financial reports that include both the providing entity and the receiving entity.

Results of Questionnaire to Executive Agencies

- 33. Prior to the Board’s deliberation on the issue, staff obtained information regarding current practices related to the accounting for imputed intra-departmental costs by distributing a questionnaire to the Chief Financial Officers and Inspector Generals of the Executive Departments. The responses to the questionnaire indicated that most Departments do not recognize imputed intra-departmental costs. Also, respondents indicated that there may be a need for guidance on various issues within SFFAS No. 4, such as materiality and acceptable methodologies.
- 34. The Board did consider the issues identified by respondents, but believed the issues were much broader than the scope of the interpretation. Additionally, the Board noted that there is existing guidance available related to cost accounting. Specifically, the CFO Council’s Cost Accounting Implementation Guide and the Joint Financial Management Improvement Program’s System Requirements for Managerial Cost Accounting, among others, are good sources of information on cost accounting.

Responses to the Exposure Draft (ED)

- 35. The Board issued the Exposure Draft “*Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*” in November 2002. The Board received twelve responses on the exposure draft from the following sources:

	Federal (internal)	Nonfederal (external)
Users, academics, others		2
Auditors	2	2
Preparers and financial managers	6	

All but two of the respondents supported the interpretation. One respondent commented that the proposed action goes beyond an interpretation of an existing standard. Many respondents (eight) did not agree with the Board’s proposed effective date.

- 36. It is important to note that the Board did not rely on the number in favor of or opposed to a given position. Information about the majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and

weighed the merits of the points raised. The respondents' comments are summarized below.

Respondents Supporting the ED

37. All but two of the respondents supported the interpretation and agreed that reporting entities should recognize imputed intra-departmental costs. One respondent stated that entities should be able to determine intra-departmental costs and apply consistent internal cost methodologies in accordance with SFFAS No. 4. Another respondent elaborated that including these costs will inform readers of the financial statements of significant costs and ensure full and complete information for decision makers.
38. Although the majority of respondents supported the interpretation, most did not agree with the proposed effective date in the ED—for reporting periods beginning after September 30, 2002 (FY 2003.) Since most departments do not currently recognize imputed intra-departmental costs and the interpretation will not be finalized until the middle of FY 2003, the respondents indicated that it would be difficult to implement during FY 2003. The Board recognizes that implementation may require reviews and studies of intra-departmental activities. Therefore, the Board believes allowing more time for implementation is appropriate. The Board agrees and the effective date of this interpretation has been changed to periods beginning after September 30, 2004, with earlier implementation encouraged.
39. Respondents supporting the ED did offer some additional comments for the Board's consideration. In particular, one respondent suggested that the proposed interpretation goes beyond what is required in SFFAS No. 4, and therefore should be covered in an amendment rather than an interpretation. The Board believes that the interpretation is a clarification of par. 110 of SFFAS No. 4 and does not impose any new requirements.

Respondents Opposing the ED

40. Two respondents did not agree that agencies should be required to recognize imputed intra-departmental costs. Specifically, both respondents believed that it would be inconsistent to require recognition of imputed costs at the intra-departmental level but not at the inter-departmental level. It is important to note that the Board believes that recognition of imputed inter-departmental costs is also required. However, when par. 110 of SFFAS No. 4 is considered in

conjunction with section 4.3 of OMB Bulletin 01-09, recognition of imputed inter-departmental costs is presently limited to those identified by OMB. A gradual approach to the implementation of inter-departmental full costing was provided by SFFAS No. 4 because the Board acknowledged a need for Government-wide guidance on the recognition of imputed inter-departmental costs.

41. The Board recognizes that costs of the same goods or services may be provided to both intra-department and inter-department recipients without full cost reimbursement. As such, certain imputed costs would be recognized by entities within a department (intra-departmental), but would not be recognized by entities that are not part of that department (inter-departmental). Although respondents note inconsistency, the Board believes it is appropriate to recognize the imputed intra-departmental costs in accordance with the standard.
42. The Board does not believe that this action will increase inconsistency. Rather, the Board believes that this interpretation is a necessary step toward consistent full cost information for the following reasons:
 - a. Current treatment of imputed costs results in receiving entities recognizing less than the full cost of the goods or services that it receives, which results in reporting understated costs. Applying this interpretation eliminates the intra-departmental misstatement.
 - b. Currently, some goods and services acquired by entities are recognized at full costs and other goods and services are not.⁵ This interpretation reduces the pool of goods and services that are not recognized at full cost.
 - c. Development of intra-departmental cost information will facilitate implementation of inter-departmental full costing. The Board believes that department management will develop cost accounting methodologies for imputed intra-departmental costs and ensure they are consistently identified and implemented

⁵ In 1998, the CFO Council published the CFO Council Cost Accounting Implementation Guide that urged agencies to enter into reimburseable agreements and thus, reduce the pool of goods and services provided at less than full cost. Therefore, implementation of the guidance should have resulted in a decline in unrecognized inter-departmental costs.

within a department. The experience gained through the intra-departmental efforts may lead to (1) full cost inter-departmental fees based on the improved cost information and (2) the availability of information and methodologies needed for imputed inter-departmental costs.

43. A task force of the Accounting and Auditing Policy Committee (AAPC) is currently identifying inter-departmental costs for recognition and guidance that will assist departments and improve consistency. The Board believes addressing the implementation issues and identifying these types of imputed intra-departmental costs for recognition within the department will ultimately assist with the obstacles in the recognition of imputed inter-departmental costs.
44. One respondent requested that the interpretation clarify how the 'broad, general support' criteria within par. 112 of SFFAS No. 4 would be applied to imputed intra-departmental costs. Par. 112 of SFFAS No. 4 (which provides general criteria to determine which costs should be recognized) discusses the criteria of broad and general support and recognizes that some entities provide support to all or most other federal entities, generally as a matter of their mission. The costs of such broad services should not be recognized as an expense (or asset) by the receiving entities when there is no reimbursement of costs. However, the standard discusses if the service is an integral and necessary part of the receiving entity's operations and outputs, those costs should be recognized.
45. The standard offers the example of check writing services by the Department of Treasury that may be considered a broad and general service to most federal entities, but may be considered an integral part of operations to entities such as the Internal Revenue Service and the Social Security Administration. Utilizing this example and applying the broad and general support criteria to imputed intra-departmental costs, the Internal Revenue Service may be required to recognize these imputed costs if they are determined to be an integral part of their operations and meet the standard for recognition, but the U.S. Customs Service (which is also a part of Treasury) may not recognize these costs as they may not be considered an integral part of their operations.
46. When appropriate, reporting entities should also consider the costing methodology standard of SFFAS No. 4 that addresses cost

accumulation and cost assignment. Specifically par. 122 of SFFAS No. 4, provides:

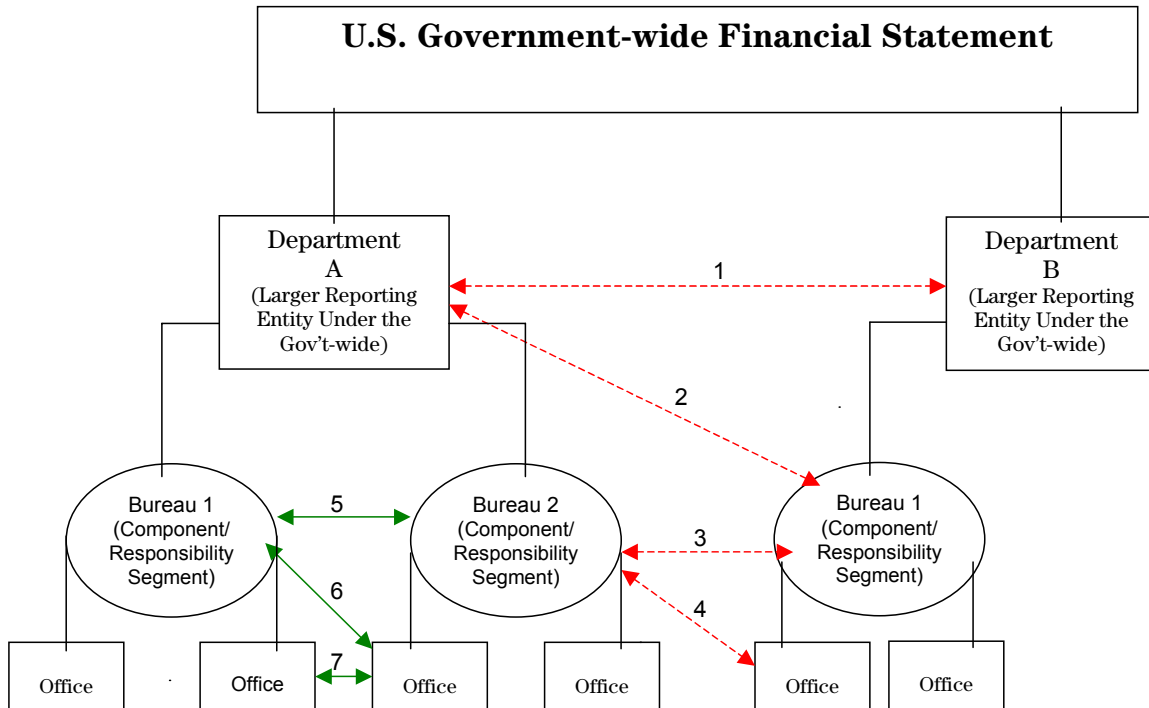
Some responsibility segments of an entity may provide supporting services or deliver intermediate products to other segments within the same entity. The costs of the supporting services and intermediate products should be assigned to the segments that receive the services and products. This is referred to as the intra-entity cost assignments. Also, in accordance with the inter-entity cost standard discussed in the preceding section, an entity should recognize inter-entity costs for goods and services received from other federal entities. The inter-entity costs should also be assigned to the responsibility segments that use the inter-entity services and products.

Board Approval

47. This interpretation was approved for issuance by all members of the Board.

Appendix B Illustration of Inter- entity Relationships

The following chart provides an illustration of the inter-departmental and intra-departmental relationships.



The lines labeled 1-7 represent goods and services provided between reporting entities.

Inter-departmental--The dashed lines (labeled 1-4) represent activities between reporting entities that are not part of the same department or larger reporting entity and are considered inter-departmental. The provision of goods or services result in inter-departmental costs and if the providing entity is not fully reimbursed, paragraph 110 of SFFAS No. 4 applies and when considered in conjunction with section 4.3 of OMB Bulletin 01-09, recognition of imputed inter-departmental costs is limited to those specifically identified by OMB.

Intra-departmental--The solid lines (labeled 5-7) represent activities between reporting entities that are part of the same department or larger reporting entity (such as bureaus, components or responsibility segments within a department) and are considered intra-departmental. The provision of goods or services result in intra-departmental costs and if the providing entity is not fully reimbursed, recognition of imputed intra-departmental costs is required to achieve full cost recognition, in accordance with SFFAS No. 4.

Technical Bulletin 2000-1: Purpose and Scope of FASAB Technical Bullentins and Procedures for Issuance

Status

Issued	June 2000
Effective Date	June 2000
Volume II References	None.
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

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1. On October 19, 1999, the Council of the American Institute of Certified Public Accountants (AICPA) adopted an amendment to Rule 203 of the AICPA's Code of Professional Ethics. This amendment recognized accounting standards published by the Federal Accounting Standards Advisory Board as generally accepted accounting principles (GAAP) for federal financial reporting entities. The amendment recognized FASAB as the source of GAAP for federal entities. Consequently, the Federal Accounting Standards Advisory Board has authorized its staff to prepare FASAB Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems of federal financial reporting entities. This Bulletin describes the purpose and scope of FASAB Technical Bulletins, the procedures for issuing them, and related background information.
2. The FASAB anticipates that it will communicate primarily through the issuance of Statements and Interpretations. Such pronouncements may require extensive due process, including appointing task forces and holding public hearings. The FASAB also recognizes the need for providing timely guidance to financial statement preparers and attestors for both currently emerging and existing problems.
3. To provide timely guidance within the context of the standard FASAB procedures, Technical Bulletin procedures provide for both due process (more limited in scope and within a tighter minimum time frame than provided for Statements and Interpretations) and review by FASAB members.
4. FASAB Technical Bulletins provide guidance for applying FASAB Statements and Interpretations and resolving accounting issues not directly addressed by them. The following kinds of guidance may be provided in a Technical Bulletin:
 - a. Guidance to clarify, explain, or elaborate on an underlying Statement or Interpretation,
 - b. Guidance to address areas not directly covered by existing Statements or Interpretations,
 - c. Interim guidance on problems in applying an existing Statement or Interpretation currently under study by the FASAB, or
 - d. If applicable, guidance for applying FASB or GASB standards to federal activities.

5. The FASAB staff analyzes an accounting or reporting problem that comes to the FASAB's attention to determine whether the problem may be resolved by issuing a FASAB Technical Bulletin. Generally, a Technical Bulletin can provide guidance if the problem can be resolved within the following guidelines:
 - a. The guidance is not expected to cause a major change in accounting practice.
 - b. The administrative cost involved in implementing the guidance is not expected to be significant to most affected entities.
 - c. The guidance does not conflict with a broad fundamental principle or create a novel accounting practice.

Generally, a FASAB Statement or Interpretation is more appropriate than a Technical Bulletin if any of these guidelines is not met.

6. FASAB members will be provided with copies of all draft Technical Bulletins before their release for comment by interested parties. Within 15 days of sending the draft TB to FASAB members, the Executive Director will review any member comments and consult with members on any issues identified. Based on the comments and consultation, the Executive Director will determine if a majority of members do not object to the proposed Technical Bulletin.
7. If a majority of the FASAB members do not object, the Executive Director will release the proposed Technical Bulletin to selected knowledgeable persons for comment. Those persons include members of the CFO Council, the President's Council on Integrity and Efficiency, the Joint Financial Management Improvement Program, CPA firms, and others the Executive Director and members of FASAB believe should be consulted. Proposed Bulletins will be publicized by electronic communication with interested parties and by posting to FASAB's World Wide Web site during an exposure period of at least 15 days.¹ The FASAB will maintain a public record of proposed Bulletins and all written comments received. The public record will be available for inspection at the FASAB's offices.

¹Determination of the length of the exposure period will depend on the nature and urgency of the issue. The Board generally prefers that exposure periods be longer than the minimum required and expects that normally exposure periods will be for at least 30 days.

8. All comments received on draft Technical Bulletins will be given to the Board for its consideration at a public meeting before final issuance. A Bulletin will not be issued if a majority of the FASAB members object either to the guidance in it or to communicating that guidance in a Technical Bulletin.
9. The FASAB may support use of a Technical Bulletin because the nature of the accounting issue addressed and the guidance provided do not, in its judgment, warrant more extensive due process. If the appropriateness of issuing a Technical Bulletin is in doubt, the FASAB may choose instead to issue a Statement or Interpretation or take other action as it deems appropriate.
10. Each Technical Bulletin will specify an effective date and transition provisions for initial application. While the FASAB expects that most Technical Bulletins will be applied prospectively, Technical Bulletins may require retroactive application if appropriate in the circumstances.
11. The FASAB monitors the procedures for issuing FASAB Technical Bulletins and may modify these procedures from time to time. Any modification will be announced publicly.
12. FASAB Technical Bulletins are generally in question-and-answer format and are published with this legend:

The Federal Accounting Standards Advisory Board has authorized its staff to prepare FASAB Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with section III. I. 5 of the Board's rules of procedure, as amended and restated through October 1, 1999 and the procedures described in FASAB Technical Bulletin 2000-1, Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance. The provisions of Technical Bulletins need not be applied to immaterial items.

The FASAB has reviewed this Technical Bulletin and a majority of its members do not object to its issuance.

Technical Bulletin 2002-1: Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government

Status

Issued	July 24, 2002
Effective Date	for periods ending after September 30, 2001
Volume II References	Liabilities (L40)
Interpretations and Technical Releases	Interpretation 2 Accounting for Treasury Judgment Fund Transactions
Affects	None.
Affected by	None.

Summary

This technical bulletin is intended to clarify the required reporting of costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government. Standards issued by FASAB have precedence over other authoritative guidance for Federal entities. This technical bulletin supplements any relevant Federal standards, but is not a substitute for and does not take precedence over the standard.

This technical bulletin requires that all liabilities and costs related to legal claims (i.e., judgments and settlements) must be attributed to the component entities responsible for the programs or activities that contributed to the claims, or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity.

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Introduction

3. Some Federal entities have requested guidance on assigning costs and liabilities resulting from legal claims (i.e., judgments and settlements) against the Federal government when one or more Federal entities are involved in the litigation. General guidance for the accounting and reporting of costs and liabilities resulting from legal claims against the Federal government is provided in Statement of Federal Financial Accounting Standards (SFFAS) Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (SFFAS 4) and Statement of Federal Financial Accounting Standards Number 5, *Accounting for Liabilities of the Federal Government* (SFFAS 5).

Effective Date

4. This technical bulletin is effective for reporting periods beginning after September 30, 2001.

Background

5. This issue is based primarily on the provisions required in the following Federal standards: SFFAS Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* and SFFAS Number 5, *Accounting for Liabilities of the Federal Government*.
6. SFFAS 4 provides a full cost standard that states: "Reporting entities should report the full costs of outputs in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities." SFFAS 4 also provides a costing methodology standard which states in part, "The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are most appropriate to the segment's operating environment and should be followed consistently." In discussing cost assignment, SFFAS 4 provided the following principles in the order of preference:
 - a. Directly tracing costs wherever economically feasible;

-
- b. Assigning costs on a cause-and-effect basis; and
 - c. Allocating costs on a reasonable and consistent basis.
7. SFFAS 5 requires that entities recognize a liability for a past event or exchange transaction that has occurred when a future outflow or other sacrifice of resources is probable and the future outflow or sacrifice of resources is measurable. "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, "probable" implies that the future confirming event or events are likely to occur. [As amended by paragraphs 10 and 11 of SFFAS 12, *Recognition of Contingent Liabilities arising from Litigation: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government*]. SFFAS 5 also requires that contingent liabilities be recognized when probable and measurable.

Technical Guidance

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- | | |
|-------|---|
| Issue | 8. What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (a) the actions of Federal component entities ¹ contribute to a legal claim having been filed against the Federal government or (b) a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government? |
|-------|---|

¹ The term "component entity" is used to distinguish between the U. S. Federal government and its components. The U. S. Federal government is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into sub organizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, *Entity and Display*, paragraphs 11-12) Use of "component entity" in this technical bulletin is only intended to distinguish between the U.S. Federal government's consolidated financial statements and financial statements of its components.

General Principles

9. All liabilities and costs must be attributed to the component entities responsible for the programs or activities that contributed to the claims or to their successor component entities. This attribution follows the general principle that all transactions or events reported on the consolidated statements should be attributed to some Federal component entity.

Implementation

10. The following hierarchy of cost assignment principles should be applied when the actions of one or more Federal component entities contribute to a legal claim having been filed against the Federal government or when a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government and it is not clear where the liability and cost should be reported.

- a. The component entities should apply the cost methodology principles provided in SFFAS 4 in the following order of preference:

- (1) Directly tracing costs wherever economically feasible;
- (2) Assigning costs on a cause-and-effect basis; and
- (3) Allocating costs on a reasonable and consistent basis.

The component entities should seek advice from the appropriate legal counsel (Office of the General Counsel, Department of Justice, etc.) about pertinent legal matters and other factors that could be relevant to assigning costs. The management of the component entities involved should work together to resolve the issues before moving on to step (b.) below.

- b. If a reasonable cost assignment or allocation cannot be determined, as outlined in step (a.) above, the component entities should seek guidance from OMB's Office of Federal Financial Management (or its successor division) and recognize costs and liabilities as directed by OMB. In addition, all component entities involved should disclose the information concerning the nature

of the costs and/or liability², the problems of assigning the costs to the component entities involved, and the estimated total liability among all the component entities involved.

The provisions of this bulletin need not be applied to immaterial items.

² See specific disclosure requirements in Interpretation 2 paragraph 3 and SFFAS 5 paragraphs 40-42.

Appendix A: Basis For Conclusions

11. This appendix summarizes some of the considerations deemed significant in reaching the conclusions in this technical bulletin. It includes the reasons for accepting certain approaches and rejecting others. Some factors had greater weight than other factors.
12. The issue raised in this technical bulletin is:
What reasonable cost assignment principles should be applied when it is not clear where the liability and cost related to legal claims (i.e., judgments and settlements) should be reported because (i) the actions Federal component entities contribute to a legal claim having been filed against the Federal government or (ii) a Federal component entity disputes that its actions contributed to the legal claim having been filed against the Federal government?
13. The Accounting and Auditing Policy Committee (AAPC) of FASAB originally proposed that in those rare instances, when allocating to one or more specific entities does not appear to be appropriate, OMB could allocate the costs directly to the consolidated financial statements of the U.S. government. However, a majority of the Board did not agree with the AAPC proposal and concluded that all costs and liabilities must be reported at the component level before flowing into the consolidated statements. Thus, the AAPC's proposed guidance was not issued as a technical release.
14. This Technical Bulletin exposure draft was issued in March 2002. During the 30-day comment period 12 comment letters were received. Eight of the respondents either said they agreed with or had no comment on the proposed guidance. Three other respondents commented on specific sections of the guidance and one additional respondent disagreed with the proposed guidance. The respondents' comments are summarized below. The Board does not simply rely on the number of respondents in favor of or opposed to a given position. The Board considers the arguments in each response and weighs the merits of the points raised. Information about respondent's views is provided only as a means of summarizing the comments.

	Federal	Non-federal
Users, academics, and others	2	1
Auditors	6	
Preparers and financial managers	3	

Respondents made the following individual comments:

- a. the initial assessment of the probability of a legal liability should be made by the respective legal counsel but legal counsel should not make accounting decisions;
- b. the attribution of liabilities to existing agencies for the activities of long-defunct federal instrumentalities, like the WWII entities, will overstate the apparent cost associated with that agency or its programs.

Based on the respondent's comment letters the Board reiterated the following conclusions.

With regard to the concern that legal counsel would not be in the position of offering accounting advice to agencies with respect to appropriate cost accounting methodology, the TB directs the component entities only to consult with legal counsel on information that may be relevant to determining the cost assignment.

With regard to legal costs of long-defunct Federal entities, the TB specifically states that component entities be responsible for their own claims as well as those of their successor component entities and that in those cases where the entities no longer exist, footnote disclosures are available for further explanations.

15. The Board's position is that all costs and liabilities must be attributed to component entities; that is, entities other than the U. S. Federal government as a whole. In general, the Board believes that the consolidated financial statements of the U. S. Federal government are a summation of component entity financial statements with appropriate intragovernmental eliminations.
16. Staff reviewed with the Board the possibility of reporting those unassigned costs and liabilities on the Treasury Judgment Fund (TJF)³

³ In 1956, Congress enacted a permanent, indefinite appropriation ("the Judgment Fund") for the payment of final judgments that were "not otherwise provided for" (i.e. which cannot legally be paid from any existing appropriation or fund). Payments from the judgment appropriations may be made only upon certification by Financial Management Service, Department of the Treasury. Treasury's role is to "oversee" the use of this appropriation.

financial statements. Staff and the Board believe TJJ should not bear the responsibility of recording all unassigned legal costs, as each component entity should accumulate and report the costs of its own activities. In addition, the TJJ is merely the funding mechanism for many of the legal settlements and judgments against the Federal government.

17. Therefore, staff concluded that entities should first apply the cost methodology principles provided in SFFAS 4 and that all legal costs must be allocated to a component entity, whether those costs are paid by the entity or by the Treasury Judgment Fund. This principle is consistent with those outlined in the Interpretation 2, *Accounting for Treasury Judgment Fund Transactions*. However, in instances when it is impossible for component entities to agree on a reasonable cost assignment or allocation basis, the entities should recognize costs and liabilities as directed by OMB. In addition, the Federal entities involved will be required to fully disclose all pertinent information related to the legal costs.

Technical Bulletin 2002-2: Disclosures Required by Paragraph 79(g) of SFFAS 7 Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting

Status

Issued	September 19, 2002
Effective Date	Immediate
Volume II References	Revenue (R40)
Interpretations and Technical Releases	None.
Affects	Paragraph 79(g) of SFFAS 7 <i>Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting</i>
Affected by	None.

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References

SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, paragraphs 77-79.

Question

1. Paragraph 77 of SFFAS 7 calls for presentation of certain material budgetary information by federal financial reporting entities “whose financing comes wholly or partially from the budget:
 - a. total budgetary resources available to the reporting entity during the period;
 - b. the status of those resources (including ‘obligations incurred’);
 - c. outlays.”
2. Paragraph 79(g) of SFFAS 7 calls for disclosure of “explanations of any material differences between the information required by paragraph 77 and the amounts described as ‘actual’ in the *Budget of the United States Government*” (also known as the “President’s Budget”).
3. If a federal financial reporting entity issues financial statements for a given fiscal year before the President’s Budget with actual numbers for the same fiscal year is published, what disclosure, if any, should the reporting entity make pursuant to paragraph 79(g) of SFFAS 7?

Response

4. The reporting entity should disclose that the President’s Budget with actual numbers for the fiscal year has not yet been published, explain when it is expected to be published, and indicate where it will be available. The information called for by paragraph 79(g) for the prior fiscal year should be included in the current financial report (unless it was included the entity’s prior report, as will be the case in the first year in which the financial report is published before the President’s Budget).
5. For example, a department that issued its financial report for FY 2001 in March of 2002 would have included the information called for by paragraph 79(g) in that report, because the President’s Budget with that information had been published before the department’s financial

report was published. If the department publishes its financial report for FY 2002 in December 2002, the department would disclose that the President's Budget with actual numbers for the fiscal year had not yet been published, explain when it is expected to be published, and indicate where it will be available. There would be no need to disclose the information called for by paragraph 79(g) with respect to FY 2001, because that information had already been reported in the FY 2001 report. If the department then publishes its financial report for FY 2003 in December 2003, that report would include the information called for by paragraph 79(g) with respect to FY 2002.

Effective Date and Transition

6. The provisions of this Technical Bulletin are effective immediately.

The Federal Accounting Standards Advisory Board has authorized its staff to prepare FASAB Technical Bulletins to provide guidance on certain financial accounting and reporting problems on a timely basis, pursuant to the procedures described in FASAB Technical Bulletin 2000-1 *Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance*. The provisions of Technical Bulletins need not be applied to immaterial items.

**Appendix:
Background
Information and
Consideration of
Comments
Received**

7. When SFFAS 7 was published in 1996, federal entities that published financial reports typically did so well after the *Budget of the United States Government* (also known as “the President’s Budget”) was published. Since 1996, several federal entities have improved their financial accounting and reporting practices to the point where they can publish financial reports before the President’s Budget is available. Most, if not all federal reporting entities are expected to do this in future years.
8. The disclosure called for by paragraph 79(g) is informative and addresses the objective of budgetary integrity, but it would be inappropriate to delay publication of the entire financial report until the President's Budget with actual numbers for the fiscal year is published. In such circumstances, the intent of paragraph 79(g) can best be accomplished as described in paragraph 4.
9. Pursuant to FASAB’s procedures for exposing a technical bulletin (TB), the proposed TB was distributed by e-mail to federal Chief Financial Officers and Inspectors General. The proposed TB was also posted on FASAB’s World Wide Web site (www.fasab.gov), and notices were sent to everyone on FASAB’s e-mail list. FASAB received 18 responses. Most supported the proposed TB or expressed no comment. Four suggested clarifying language or expressed concerns that implied a need for clarification. Accordingly, paragraph 5 was added to illustrate the effect of applying the Technical Bulletin.
10. The Board reviewed the proposed TB and the comments at its meeting on August 8, 2002. The TB was revised as discussed in paragraph 9 and distributed to the Board. FASAB’s Executive Director determined that a majority of the FASAB did not object to the TB as revised, and accordingly posted the TB to www.fasab.gov.

Technical Bulletin 2003-1: Certain Questions and Answers Related to the Homeland Security Act of 2002

Status

Issued	June 13, 2003
Effective Date	for periods ending after September 30, 2002
Volume II References	None.
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

Summary

- I. This technical bulletin answers certain questions arising from the creation of the Department of Homeland Security and other transfers of operations between federal entities directed by the Homeland Security Act of 2002. Standards issued by the Federal Accounting Standards Advisory Board (FASAB) have precedence over other sources of generally accepted accounting principles for Federal entities. This technical bulletin supplements any relevant Federal standards, but is not a substitute for and does not take precedence over standards and interpretations issued by FASAB.
- II. The primary effects of this technical bulletin are that:
 - a. Legacy entities will segregate the net costs of continuing and transferred operations, and recognize a transfer-out for assets and liabilities transferred. Segregation of the net cost is required for both current and prior period net cost.
 - b. Transferred entities will segregate the net costs of continuing and transferred operations for components of the transferred entity that (1) were not transferred from the legacy entity or (2) subsequent to the creation of the Department of Homeland Security were no longer included in the transferred entity's operations. Transferred entities will recognize a transfer-out for assets and liabilities transferred. Segregation of the net cost is required for both current and prior period net cost.
 - c. Department of Homeland Security and other receiving entities will recognize assets and liabilities received at book value¹ and recognize a "transfer-in." Financial statements based on the transfers and actual operations subsequent to the transfer will be presented.

¹"Book value" is the net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

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- III. Guidance on segregating the net costs of continuing and transferred operations is consistent with Financial Accounting Standard 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Guidance on transfers of assets and liabilities is consistent with Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources*.

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Introduction

1. The Homeland Security Act of 2002 impacts many federal entities in varying ways. The purpose of this Technical Bulletin is to provide accounting and reporting guidance for legacy, transferred and receiving entities. The guidance is based largely on Financial Accounting Standard (FAS) 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, modified to fit the circumstances of federal entities. The objective is to provide comparable information for entities affected by the HS Act to the extent feasible.

Effective Date

2. This technical bulletin is effective for reporting periods beginning after September 30, 2002.

Technical Guidance

Scope

3. **What entities' accounting practices are addressed in this Technical Bulletin?**
4. This guidance is limited to transfers of functions², personnel, assets, and liabilities resulting from the Homeland Security Act of 2002 (HS Act³). The following types of entities affected by the HS Act are addressed:
 - a. "Receiving entity" refers to an entity to which functions are transferred.
 - b. "Legacy entity" refers to an entity from which a smaller entity or specific function is being transferred.

² The HS Act provides for the transfer of functions, personnel, assets, and liabilities. The term "functions" includes authorities, powers, rights, privileges, immunities, programs, projects, activities, duties, and responsibilities. The term "operations" is more commonly used in accounting literature and is sometimes used as a substitute for "functions" in this document.

³ Public Law 107-296, 116 Stat. 2135, November 25, 2002.

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- c. “Transferred entity” refers to an entity preparing stand-alone financial statements consolidated with a legacy entity’s financial statements prior to transfer and with a receiving entity’s financial statements after transfer.⁴

APB 20 Is Not
Applicable

5. **Should receiving, legacy, and/or transferred entities apply Accounting Principles Bulletin (APB) 20 (par. 12 and 35) guidance for a change in entity? (See Appendix B, page 21, for the relevant text of APB 20)**
6. No. APB 20 should not be applied to any of the changes resulting from transfers of functions among federal entities due to the HS Act.

FAS 144 is Applicable

Accounting by Legacy
Entities

7. **Should legacy entities apply Financial Accounting Standard (FAS) 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*,⁵ in accounting for and reporting on components of the entity⁶ transferred to receiving entities? (See Appendix C, page 1224, for the relevant text of FAS 144)**
8. Yes. FAS 144 par. 41 to 44 and 47(a)⁷ should be applied by legacy entities with the exception of par. 43 guidance requiring recognition of

⁴ Guidance is provided for transferred entities because it is possible that functions would be transferred back to the legacy entity. The Office of Management and Budget (OMB) plan for Department of Homeland Security (DHS) specifically provides that “any functions of those entities that are not directly related to securing the homeland will continue to be allocated to the agencies and subdivisions in which they are currently incorporated.”

⁵ This Technical Bulletin addresses questions related to applying FAS 144 to a federal reporting entity. While this Technical Bulletin discusses many aspects of applying FAS 144, it does not provide a comprehensive illustration.

⁶ FAS 144, par. 41 states that “a component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.”

⁷ Paragraph 47(a) requires the following disclosure: A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the statement, the carrying amount(s) of the major classes of assets and liabilities included as part of a disposal group.

a gain or loss on disposal (see par. 12 through 14 below). While FAS 144 uses the term “discontinued operations”, legacy entities should use the term “Transferred Operations” as appropriate.⁸

- 9. In reporting the “results of operations of the component” for current and prior periods as required by par. 43 of FAS 144 (see page 1224), what information should the legacy entities report?**
10. For all periods presented, legacy entities should report material amounts of gross cost, exchange revenue, and net cost for transferred or discontinued components of the entity (as defined by par. 41 of FAS 144 - see page 1224). In some cases, functions may be discontinued or transferred but may not be “components of the entity” as defined in par. 41 of FAS 144. If functions are not “components of the entity” there is no requirement to separately report the function’s results of operations under FAS 144.
11. The Statement of Net Cost should present a sub-total for “Net Cost of Continuing Operations” immediately before the presentation of amounts related to transferred and/or discontinued operations. All elements related to transferred and/or discontinued operations should be appropriately labeled. For example, for transferred operations:

Net Cost of Continuing Operations	\$XX
<hr/>	
Transferred Operations:	
Cost of Transferred Operations	\$ XX
Exchange Revenue from Transferred Operations	XX
<hr/>	
Net Cost of Transferred Operations	XX
Net Cost	\$XX

- 12. What amount should legacy entities report for the transfer of assets and liabilities?**

⁸ All affected entities are components of the Federal Government as a whole. Thus, all statements should clearly distinguish between operations that are transferred versus truly “discontinued.” While the operations may be discontinued at one entity – they may be continued at another entity. Thus, the term “transferred” may be more appropriate.

Accounting by Transferred
Entities

13. SFFAS 7, par. 74, provides that transfers between entities without reimbursement should be recognized as “transfers-in⁹ or out” on the Statement of Changes in Net Position. The amount transferred is equivalent to the book value¹⁰ of all assets and liabilities transferred.
14. This SFFAS 7 guidance precludes application of FAS 144’s requirement that gains and losses be included in the results of operations of discontinued or transferred operations (FAS 144, par. 37 and 43).
15. **Does FAS 144 require legacy entities to segregate the Statements of Budgetary Resources and Financing between continuing and transferred and/or discontinued operations?**
16. No. There are no FAS 144 requirements that would apply to the Statements of Budgetary Resources and Financing.¹¹
17. **Should a transferred entity preparing its own financial statements apply FAS 144 par. 41 through 44 and 47(a) to reporting on discontinued or transferred components of the entity?**
18. Yes. If a transferred entity had material components (as defined by FAS 144 par. 41) that were not also transferred with the rest of the entity, the transferred entity should apply FAS 144, par. 41 through 44

⁹It is possible to have a negative transfer-out at the legacy entity because liabilities transferred may exceed assets transferred.

¹⁰“Book value” is the net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

¹¹ While these statements may be affected by transactions related to the HS Act, this Technical Bulletin provides guidance on application of FAS 144 in light of existing federal guidance. FAS 144 requirements relate primarily to exchange transactions as well as events associated with operations. Thus, FAS 144 requirements do not extend to these statements.

and 47(a) and par. 10 and 11 above and report separately the results of continuing and transferred operations.¹²

19. What additional disclosures should a transferred entity preparing free-standing entity-level financial statements provide?

20. Transferred entities should disclose:

- a. a description of the facts and circumstances leading to the transfer,
- b. the timing of the transfer,
- c. significant changes in its operations as a result of the transfer, and
- d. the net cost attributable to the transferred entity's pre-transfer operations (this amount is equal to the amount the legacy entity would report as "net cost of discontinued or transferred operations" per par. 10 above).

Accounting by Receiving Entities

21. How will receiving entity financial statements report on the transfer of components and functions from legacy entities?

22. Receiving entities will recognize assets and liabilities based on the legacy entities' book values at the time of transfer. SFFAS 7, par. 74 provides guidance for transfers-in and requires that transferred assets be recognized by the receiving entity at the legacy entity's book value.¹³

¹² For example, an entity may transfer to DHS "except for" certain functions that remain with the legacy entity. If these un-transferred functions are carried out by a component of the entity as defined in FAS 144 par. 41 and the associated amounts are material, the related revenues and costs would be reported under "transferred operations" per par. The Statement of Net Cost should present a sub-total for "Net Cost of Continuing Operations" immediately before the presentation of amounts related to transferred and/or discontinued operations. All elements related to transferred and/or discontinued operations should be appropriately labeled. For example, for transferred operations:

¹³ The net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

-
23. The net effect of the assets and liabilities received will be recognized as a “transfer-in” on the receiving entity’s Statement of Changes in Net Position. Note that it is possible to have a negative transfer-in at the receiving entity because liabilities transferred may exceed assets transferred.
24. Receiving entities will prepare financial statements based on the transfers and actual operations subsequent to the transfer.

The provisions of this bulletin need not be applied to immaterial items.

Appendix A: Basis For Conclusions

25. The Federal Accounting Standards Advisory Board has authorized its staff to prepare FASAB Technical Bulletins to provide timely guidance on certain financial accounting and reporting problems, in accordance with section III. I. 5 of the Board's rules of procedure, as amended and restated through October 1, 1999 and the procedures described in FASAB Technical Bulletin 2000-1, Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance. The provisions of Technical Bulletins need not be applied to immaterial items.
26. An exposure draft was issued March 21, 2003 and the Board considered responses to the exposure draft at its April 24, 2003 public meeting. The FASAB has reviewed this Technical Bulletin and a majority of its members do not object to its issuance.
27. This appendix discusses some factors considered significant by staff in reaching the conclusions in this Technical Bulletin. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors. The guidance enunciated in the technical guidance section—not the material in this appendix—should govern the accounting for specific transactions, events or conditions

APB 20 Is Not Applicable

28. APB 20 defines a “change in entity” as:

This type [of accounting change] is limited mainly to (a) presenting consolidated or combined statements in place of statements of individual companies, (b) changing specific subsidiaries comprising the group of companies for which consolidated financial statements are presented, and (c) changing the companies included in combined financial statements. A different group of companies comprise the reporting entity after each change. (Financial Accounting Standards Board, Original Pronouncements, Change in Reporting Entity (par. 12))

29. APB 20 requires restatement when a “change in entity” occurs. Restatement means the “recasting of a previously determined (and published) balance sheet or operating statement, and its republication where there has been a substantial change in accounting principles or policies.” (Kohler's Dictionary for Accountants) For private-sector entities a complete set of comparable financial statements for an individual reporting entity is critical to lending and investing

decisions.¹⁴ The current and prior period financial statements assist in discerning the earning power and credit-worthiness of entities thus trends in assets, liabilities and results of operations are essential.

30. Federal financial reporting objectives do not focus on the earning power or credit worthiness of the component entities of the government. Instead, federal financial reporting objectives focus on:
- a. Compliance with laws and regulations governing the use of resources (budgetary integrity);
 - b. Evaluating the service efforts and accomplishments of a reporting entity (operating performance) as well as the entity's management of assets and liabilities;
 - c. Assessing the government's financial position and changes in its financial position (stewardship); and
 - d. Assuring that systems and controls support compliance with laws and regulations (systems and controls).
31. Restatement may obscure information about the changes directed by the HS Act since restatement would portray financial information as if

¹⁴ FASB Concepts Statement 1: Objectives of Financial Reporting by Business Enterprises states that:

—Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

—Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.

—Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources.

the event occurred prior to its enactment and effective date. Portraying the actual results of operations including actual transfers of assets and liabilities for which an entity is legally accountable is most consistent with federal reporting objectives. Thus, staff does not believe restatement aids in meeting federal financial reporting objectives.

32. Further, staff does not believe that comparable financial statements for all affected entities could result from the restatement envisioned by APB 20. Staff does not believe that the changes required by the HS Act are “changes in entity” as defined in APB 20. APB 20 describes a change in entity as “changing specific subsidiaries for which consolidated financial statements are presented.” The APB 20 description does not fit all of the changes required by the HS Act. The HS Act requires concurrent changes within entities that are transferred as well as realignment of entities and operations that are part of a single larger entity both before and after the change.
33. Respondents to the March 21, 2003 exposure draft supported the staff’s assertion that APB 20 is not applicable. Some respondents suggested that the scope of the Technical Bulletin be expanded so that APB 20 would not be applied to any future changes at the federal level. Staff has not incorporated this suggestion but has recommended that the Board consider it when an opportunity to address new issues arises in the future.

Applicability of FAS 144

34. FAS 144 addresses discontinued operations and provides for separate reporting of the results of operations associated with discontinued operations. The standard provides a definition of “component of an entity” (FAS 144, par. 41, see page 1224) as well as criteria for determining if the activity of the component has been discontinued (FAS 144, par. 42, see page 1224).
35. Under the HS Act, functions may be discontinued at the legacy entity, but not discontinued by the government-as-a-whole. Therefore, the term “transferred” operations should be substituted for “discontinued” operations when appropriate. This will ensure that the reader does not

conclude that the government has stopped performing certain functions.¹⁵

36. FAS 144 provides guidance that – in the private sector – results in segregation of critical information directly linked to operations that are either continuing or discontinued. Application of FAS 144 to entities affected by the Homeland Security Act of 2002 will result in:
- a. Legacy and transferred entities providing comparable financial information for continuing operations by separately identifying the net cost of continuing and transferred operations on the face of the Statement of Net Cost for all periods presented; and
 - b. Receiving entities preparing Statements of Net Cost based on the actual operations subsequent to the transfer.
37. This will result in the most useful presentation since it produces a consistent and understandable result across all entities.
38. Respondents to the March 21, 2003 exposure draft supported the staff’s assertion that FAS 144 is applicable. Some respondents suggested that the scope of the Technical Bulletin be expanded so that FAS 144 would be applied to any future changes at the federal level. Staff has not incorporated this suggestion but has recommended that the Board consider it when an opportunity to address new issues arises in the future.
39. Some respondents asked for specific guidance on the transfer of general property, plant, and equipment (PP&E). The questions posed were:
- a. Should a capitalization threshold be applied to the book value upon transfer?
 - b. Should the acquisition date be adjusted to the transfer date?
 - c. Should the gross book and associated accumulated depreciation be recorded or should the PP&E be booked at “net”?

Respondents’ Request for
Guidance on General PP&E
Transfers

¹⁵ “Discontinued operations” may be appropriate in the event that material functions are discontinued.

Respondents' Request for Guidance on the Statements of Custodial Activity and Changes in Net Position

40. Staff has not incorporated guidance on these questions in this Technical Bulletin. The questions posed are procedural in nature. Staff believes management may determine the most effective procedures to accomplish the initial recognition of the book value of general PP&E and its depreciation during the operating period.
41. Some respondents asked whether collections for which the collecting function was transferred should be separately disclosed on the face of or in notes to the Statement of Custodial Activity. Staff has not included in this Technical Bulletin this requirement or expressed a preference for the suggested display. However, staff notes that there is nothing precluding the suggested treatment. Staff did not believe the issue was controversial enough to suggest a proposed resolution.
42. Some respondents suggested that the Statement of Changes in Net Position also should present separate amounts for continuing and transferred (or discontinued) operations. While this proposal may be explored at a future time, staff does not believe it would be appropriate to impose this requirement through a Technical Bulletin. Technical Bulletins receive minimal due process. Thus, limitations are placed on the types of requirements that may be imposed in a Technical Bulletin.
43. Technical Bulletin 2000-1 provides that staff may pursue an issue through a Technical Bulletin if:
- a. the guidance is not expected to cause a major change in accounting practice. (TB 2000-1, par. 5a)
 - b. the administrative cost involved in implementing the guidance is not expected to be significant to most affected entities. (TB 2000-1, par. 5b)
 - c. the guidance does not conflict with a broad fundamental principle or create a novel accounting practice. (TB 2000-1, par. 5c)
44. In this case, staff elected to rely on practices developed through full due process in other domains by searching GAAP for non-governmental entities for relevant requirements. FAS 144 was found to be the best fit for this circumstance. In relating the FAS 144 guidance to the federal reporting model, staff was mindful that FAS 144

provisions are applicable to revenues, expenses, gains and losses resulting from exchange transactions and related events. Staff found that the elements for which FAS 144 requires segregation aligned with the elements presented on the Statement of Net Cost.

45. Staff does not believe that FAS 144 requirements extend logically to financing sources presented on the Statement of Changes in Net Position. Thus, FAS 144 would not support a requirement that federal entities segregate continuing and transferred/discontinued financing sources.
46. In addition, the federal reporting model requires entities to report net cost by program while reporting financing sources for the entity as a whole. Staff believes that requiring the Statement of Changes in Net Position to present information for a transferred/discontinued “component of an entity” is arguably a major change in practice from aggregated to disaggregated financing information.
47. Therefore, staff believes segregation of the Statement of Changes in Net Position warrants greater due process than that provided through a Technical Bulletin and has not incorporated the respondents’ suggestions in this Technical Bulletin.
48. As mentioned in par. 44, FAS 144 does not require segregation of information beyond the results of continued and discontinued operations. Since the Statement of Budgetary Resources does not report the results of operations, FAS 144 would not support a requirement that federal entities segregate elements of the Statement of Budgetary Resources between continuing and transferred/discontinued budgetary and reconciling elements. For reasons similar to those provided in paragraphs 42 through 46, staff does not believe this Technical Bulletin should require segregation of the elements of this statement.
49. Staff also notes that the Statement of Budgetary Resources presents information intended to support the “budgetary integrity” reporting objective. This reporting objective provides that “Federal financial reporting should assist in fulfilling the government’s duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government’s budget for a particular fiscal year and related laws and regulations.”(SFFAC 1, par. 112)

Statement of Budgetary Resources

50. Thus, the information presented on the Statement of Budgetary Resources relates to compliance with budgetary provisions including reporting on transfers of budgetary resources associated with the HS Act. It also relates to the current availability of budgetary resources. It is less clear that the Statement of Budgetary Resources is intended to provide information needed to determine whether financing sources will be “continuing.” In addition, SFFAS 7, par. 79 currently requires extensive disclosures relating to legislative actions affecting resources provided to entities. Thus, staff does not believe that immediate changes to the Statement of Budgetary Resources are needed to ensure that federal financial reporting objectives are met.
51. Generally, staff believes that existing guidance in accounting standards, guidance from the Office of Management and Budget regarding the Statement of Budgetary Resources (e.g., OMB Circular A-11 which is referenced by SFFAS 7, par. 78), and other operational guidance will assist in resolving some of the other issues raised by respondents.

Statement of Financing

52. SFFAS 7 indicates that the purpose of the Statement of Financing is:
- .. to explain how budgetary resources obligated during the period relate to the net cost of operations for that reporting entity. This information should be presented in a way that clarifies the relationship between the obligation basis of budgetary accounting and the accrual basis of financial (i.e., proprietary) accounting. By explaining this relationship through a reconciliation, the statement provides information necessary to understand how the budgetary (and some nonbudgetary) resources finance the cost of operations and affect the assets and liabilities of the reporting entity. (SFFAS 7, par. 95)
53. Staff does not believe that SFFAS 7 envisioned explanations of these relationships in greater detail than the “reporting entity” level. To impose a greater disaggregation would, in staff’s opinion, require greater due process than afforded for a Technical Bulletin.

Unique Federal Guidance Sought by Some Respondents

54. Some respondents agreed that the result of applying FAS 144 was desirable but asserted that standards tailored to the unique federal environment and reporting model should be developed. Staff believes this Technical Bulletin provides important guidance in response to an immediate need. Given the limited due process associated with Technical Bulletins, staff believes that – in this case – it was

appropriate to rely on non-federal accounting standards to support a solution that fits the circumstances and meets federal reporting objectives.

Effective Date

55. The effective date of this Technical Bulletin – for reporting periods beginning after September 30, 2002 – is necessary due to the timing of the HS Act. Staff does not routinely issue pronouncements that are effective in the period issued but must do so in this case to provide timely guidance.

**Appendix B:
Accounting
Principles Board
Opinion 20**

Excerpt From FASB's Original Pronouncements

Changes in Accounting Principles
Change in Reporting Entity

APB20, Par. 12

12. One special type of change in accounting principle results in financial statements which, in effect, are those of a different reporting entity. This type is limited mainly to (a) presenting consolidated or combined statements in place of statements of individual companies, (b) changing specific subsidiaries comprising the group of companies for which consolidated financial statements are presented, and (c) changing the companies included in combined financial statements. A different group of companies comprise the reporting entity after each change.

35. Disclosure. The financial statements of the period of a change in the reporting entity should describe the nature of the change and the reason for it. In addition, the effect of the change on income before extraordinary items, net income, and related per share amounts should be disclosed for all periods presented. Financial statements of subsequent periods need not repeat the disclosures. (Paragraphs 56 to 65 and 93 to 96 of APB Opinion No. 16, Business Combinations, describe the manner of reporting and the disclosures required for a change in reporting entity that occurs because of a business combination.)

Appendix C:
Excerpt From
Financial
Accounting
Standard 144,
*Accounting for the
Impairment or
Disposal of Long-
Lived Assets*

FAS144, Par. 41

41. For purposes of this Statement, a component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment (as those terms are defined in paragraph 10 of Statement 131), a reporting unit (as that term is defined in Statement 142), a subsidiary, or an asset group (as that term is defined in paragraph 4).
42. The results of operations of a component of an entity that either has been disposed of or is classified as held for sale shall be reported in discontinued operations in accordance with paragraph 43 if both of the following conditions are met: (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. (Examples 12-15 of Appendix A illustrate disposal activities that do or do not qualify for reporting as discontinued operations.)
43. In a period in which a component of an entity either has been disposed of or is classified as held for sale, the income statement of a business enterprise (or statement of activities of a not-for-profit organization) for current and prior periods shall report the results of operations of the component, **including any gain or loss recognized in accordance with paragraph 37** [emphasis added], in discontinued operations. The results of operations of a component classified as held for sale shall be reported in discontinued operations in the period(s) in which they occur. The results of discontinued operations, less applicable income taxes (benefit), shall be reported as a separate component of income before extraordinary items and the cumulative effect of accounting changes (if applicable). For example, the results of discontinued operations may be reported in the income statement of a business enterprise as follows:

Income from continuing operations before income taxes	\$XXXX
Income taxes	XXX
Income from continuing operations ²⁴	\$XXXX
Discontinued operations (Note X)	
Loss from operations of discontinued Component X (including loss on disposal of \$XXX)	XXXX
Income tax benefit	XXXX
Loss on discontinued operations	XXXX
Net income	\$XXXX

²⁴This caption shall be modified appropriately when an entity reports an extraordinary item or the cumulative effect of a change in accounting principle or both in accordance with Opinion 20. If applicable, the presentation of per-share data will need similar modification.

A gain or loss recognized on the disposal shall be disclosed either on the face of the income statement or in the notes to the financial statements (paragraph 47(b)).

44. Adjustments to amounts previously reported in discontinued operations that are directly related to the disposal of a component of an entity in a prior period shall be classified separately in the current period in discontinued operations. The nature and amount of such adjustments shall be disclosed. Examples of circumstances in which those types of adjustments may arise include the following:
- a. The resolution of contingencies that arise pursuant to the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser
 - b. The resolution of contingencies that arise from and that are directly related to the operations of the component prior to its disposal, such as environmental and product warranty obligations retained by the seller

-
- c. The settlement of employee benefit plan obligations (pension, postemployment benefits other than pensions, and other postemployment benefits), provided that the settlement is directly related to the disposal transaction.²⁵
- Reporting Disposal Gains or Losses in Continuing Operations
45. A gain or loss recognized for a long-lived asset (disposal group) classified as held for sale that is not a component of an entity shall be included in income from continuing operations before income taxes in the income statement of a business enterprise and in income from continuing operations in the statement of activities of a not-for-profit organization. If a subtotal such as "income from operations" is presented, it shall include the amounts of those gains or losses.
- Reporting a Long-Lived Asset or Disposal Group Classified as Held for Sale
46. A long-lived asset classified as held for sale shall be presented separately in the statement of financial position. The assets and liabilities of a disposal group classified as held for sale shall be presented separately in the asset and liability sections, respectively, of the statement of financial position. Those assets and liabilities shall not be offset and presented as a single amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either on the face of the statement of financial position or in the notes to financial statements (paragraph 47(a)).
- Disclosure
47. The following information shall be disclosed in the notes to the financial statements that cover the period in which a long-lived asset (disposal group) either has been sold or is classified as held for sale:
- a. A description of the facts and circumstances leading to the expected disposal, the expected manner and timing of that disposal, and, if not separately presented on the face of the statement, the carrying amount(s) of the major classes of assets and liabilities included as part of a disposal group

²⁵ Paragraph 3 of FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, defines *settlement* as "a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a pension benefit obligation, and (c) eliminates significant risks related to the obligations and the assets used to effect the settlement." A settlement is directly related to the disposal transaction if there is a demonstrated direct cause and effect relationship and the settlement occurs no later than one year following the disposal transaction, unless it is delayed by events or circumstances beyond an entity's control (refer to paragraph 31).

- b. The gain or loss recognized in accordance with paragraph 37 and if not separately presented on the face of the income statement, the caption in the income statement or the statement of activities that includes that gain or loss
 - c. If applicable, amounts of revenue and pretax profit or loss reported in discontinued operations
 - d. If applicable, the segment in which the long-lived asset (disposal group) is reported under Statement 131.
48. If either paragraph 38 or paragraph 40 applies, a description of the facts and circumstances leading to the decision to change the plan to sell the long-lived asset (disposal group) and its effect on the results of operations for the period and any prior periods presented shall be disclosed in the notes to financial statements that include the period of that decision.

Examples 12–15—Reporting Discontinued Operations

- A24. The results of operations of a component of an entity that either has been disposed of or is classified as held for sale shall be reported in discontinued operations if (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction (paragraph 42). Examples 12–15 illustrate disposal activities that do or do not qualify for reporting as discontinued operations.

Example 12

- A25. An entity that manufactures and sells consumer products has several product groups, each with different product lines and brands. For that entity, a product group is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each product group is a component of the entity.
- A26. The entity has experienced losses associated with certain brands in its beauty care products group.
- a. The entity decides to exit the beauty care business and commits to a plan to sell the product group with its operations. The

product group is classified as held for sale at that date. The operations and cash flows of the product group will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the product group after it is sold. In that situation, the conditions in paragraph 42 for reporting in discontinued operations the operations of the product group while it is classified as held for sale would be met.

- b. The entity decides to remain in the beauty care business but will discontinue the brands with which the losses are associated. Because the brands are part of a larger cash-flow-generating product group and, in the aggregate, do not represent a group that on its own is a component of the entity, the conditions in paragraph 42 for reporting in discontinued operations the losses associated with the brands that are discontinued would not be met.

Example 13

A27. An entity that is a franchiser in the quick-service restaurant business also operates company-owned restaurants. For that entity, an individual company-owned restaurant is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each company-owned restaurant is a component of the entity.

- a. The entity has experienced losses on its company-owned restaurants in one region. The entity decides to exit the quick-service restaurant business in that region and commits to a plan to sell the restaurants in that region. The restaurants are classified as held for sale at that date. The operations and cash flows of the restaurants in that region will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the restaurants after they are sold. In that situation, the conditions in paragraph 42 for reporting in discontinued operations the operations of the restaurants while they are classified as held for sale would be met.

- b. Based on its evaluation of the ownership mix of its system-wide restaurants in certain markets, the entity commits to a plan to sell its company-owned restaurants in one region to an existing franchisee. The restaurants are classified as held for sale at that date. Although each company-owned restaurant, on its own, is a component of the entity, through the franchise agreement, the entity will (1) receive franchise fees determined, in part, based on the future revenues of the restaurants and (2) have significant continuing involvement in the operations of the restaurants after they are sold. In that situation, the conditions in paragraph 42 for reporting in discontinued operations the operations of the restaurants would not be met.

Example 14

A28. An entity that manufactures sporting goods has a bicycle division that designs, manufactures, markets, and distributes bicycles. For that entity, the bicycle division is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the bicycle division is a component of the entity.

A29. The entity has experienced losses in its bicycle division resulting from an increase in manufacturing costs (principally labor costs).

- a. The entity decides to exit the bicycle business and commits to a plan to sell the division with its operations. The bicycle division is classified as held for sale at that date. The operations and cash flows of the division will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the division after it is sold. In that situation, the conditions in paragraph 42 for reporting in discontinued operations the operations of the division while it is classified as held for sale would be met.
- b. The entity decides to remain in the bicycle business but will outsource the manufacturing operations and commits to a plan to sell the related manufacturing facility. The facility is classified as held for sale at that date. Because the manufacturing facility is part of a larger cash-flow-generating group (the bicycle division), and on its own is not a component of the entity, the conditions in

paragraph 42 for reporting in discontinued operations the operations (losses) of the manufacturing facility would not be met. (Those conditions also would not be met if the manufacturing facility on its own was a component of the entity because the decision to outsource the manufacturing operations of the division will not eliminate the operations and cash flows of the division [and its bicycle business] from the ongoing operations of the entity.)

Example 15

- A30. An entity owns and operates retail stores that sell household goods. For that entity, each store is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each store is a component of the entity.
- A31. To expand its retail store operations in one region, the entity decides to close two of its retail stores and open a new “superstore” in that region. The new superstore will continue to sell the household goods previously sold through the two retail stores as well as other related products not previously sold. Although each retail store on its own is a component of the entity, the operations and cash flows from the sale of household goods previously sold through the two retail stores in that region will not be eliminated from the ongoing operations of the entity. In that situation, the conditions in paragraph 42 for reporting in discontinued operations the operations of the stores would not be met.

Federal Financial Accounting and Auditing Technical Release 1: Audit Legal Representation Letter Guidance

Status

Issued	March 1, 1998
Effective Date	For fiscal periods beginning after September 30, 1997
Volume II References	Liabilities (L40)
Interpretations and Technical Releases	Interpretation 2, <i>Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5</i>
Affects	None.
Affected by	None.

Summary

Management of the Federal reporting entity is responsible for adopting policies and procedures to identify, evaluate and account for litigation, claims and assessments as a basis for the preparation of financial statements, including those handled by outside legal counsel. Management is responsible for reporting loss contingencies in accordance with the requirements of Statement of Federal Financial Accounting Standards No.5. This may require consultation by management and its legal department with DOJ, as well as other outside legal counsel.

The auditor should request that management send a letter of audit inquiry to legal counsel with whom management has consulted concerning litigation, claims and assessments. Management of the Federal reporting entity and its legal department are responsible for providing the auditor with a legal representation letter.

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Issue:

Who should be the source of audit legal representation letters in cases where Department of Justice attorneys are handling legal matters on behalf of other Federal reporting entities?

Background:

This issue was raised by the Department of Justice (DOJ) in relation to Interpretation No. 2, Accounting for Treasury Judgment Fund Transactions, issued by the Federal Accounting Standards Advisory Board (FASAB), however it is applicable to any situation where outside legal counsel is handling legal matters on behalf of a Federal reporting entity.

FASAB Interpretation No. 2 states that "the Federal entity's management, as advised by the Justice Department, must determine whether it is probable that a legal claim will end in a loss for the Federal entity and the loss is estimable." DOJ is concerned that the language in the Interpretation will lead agencies to conclude that DOJ is the sole source of audit legal representation letters in cases where DOJ attorneys are handling legal matters on behalf of other Federal reporting entities.

Recommended Implementation Guidance

Management of the Federal reporting entity is responsible for adopting policies and procedures to identify, evaluate and account for litigation, claims and assessments as a basis for the preparation of financial statements in accordance with the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These include litigation, claims and assessments handled by legal counsel outside of the Federal reporting entity's legal department.

Management of the Federal reporting entity is responsible for ensuring that loss contingencies, including those arising from litigation, claims and assessments, are presented in the financial statements in accordance with the requirements of Statement of Federal Financial Accounting Standards No.5, *Accounting for Liabilities of the Federal Government*. This may require consultation by management and its legal department with DOJ, as well as other outside legal counsel, to ensure the accuracy and completeness of the presentation of matters related to litigation, claims and assessments in the Federal reporting entity's financial statements. Such

consultation may include requesting a list of pending litigation, claims and assessments from DOJ or other outside legal counsel.

A representation letter from legal counsel to the auditor, in response to a letter of audit inquiry from management to legal counsel, is the auditor's primary means of corroborating the information furnished by management concerning the accuracy and completeness of litigation, claims and assessments. The auditor should request that management send a letter of audit inquiry to legal counsel with whom management has consulted concerning litigation, claims and assessments. A materiality limit for the legal representation letter is generally established in the letter of audit inquiry, based on an understanding between management and the auditor.

Management of the Federal reporting entity and its legal department are responsible for providing the auditor with a legal representation letter. The legal representation letter should cover all litigation, claims and assessments pertaining to the Federal reporting entity, including matters handled by DOJ or other outside legal counsel on behalf of the Federal reporting entity.

The legal representation letter provided to the auditor by the Federal reporting entity's legal department, or "inside counsel", may provide sufficient evidential matter for the auditor. In certain circumstances the auditor may also need supporting legal representation from outside counsel. Section AUI 337.26 of the AICPA Codification of Statements on Auditing Standards provides the following guidance for situations where inside counsel is handling litigation, claims and assessments either exclusive of or in conjunction with outside counsel:

Audit inquiry letters should be sent to those lawyers, which may be either inside or outside lawyers, who have the primary responsibility for, and knowledge about, particular litigation, claims and assessments. If inside counsel is handling litigation, claims and assessments exclusively, their evaluation and response ordinarily would be considered adequate. Similarly, if both inside and outside lawyers have been involved in the matters, but inside counsel has assumed primary responsibility for the matters, inside counsel's evaluation may well be considered adequate. However, there may be circumstances where litigation, claims and assessments involving substantial overall participation by outside lawyers are of such significance to the financial statements that the auditor should consider obtaining the outside lawyers' response that they have not

formulated a substantive conclusion that differs in any material respect from inside counsel's evaluation, even though inside counsel may have primary responsibility.

In those circumstances where the auditor determines that a legal representation letter is needed from DOJ, or other outside legal counsel, to support the Federal reporting entity's legal representation letter, the Federal reporting entity's management, in conjunction with its legal department, would request such representation in a letter of audit inquiry. The Federal reporting entity would provide DOJ with its description and evaluation of the possible outcome of the case in question, and request that the DOJ lawyer respond directly to the auditor. If the Federal reporting entity is not sufficiently knowledgeable of the case to provide a description and evaluation, the DOJ lawyer would be requested to provide a description and evaluation directly to the auditor. Such requests to DOJ should be case specific and directed to the lead DOJ lawyer handling the case. To meet the reporting deadlines for audited financial statements, there should be early coordination between the auditor and the Federal reporting entity's management and legal department to determine whether supporting legal representations will be needed from DOJ.

The legal representation letter provided to the auditor by the legal department of the Federal reporting entity requires an assertion as to the completeness of the list of litigation, claims and assessments, including matters handled by DOJ or other outside legal counsel on behalf of the Federal reporting entity. The auditor's consideration of this completeness assertion is based primarily on the assessed effectiveness of the Federal reporting entity's internal control structure for identifying, evaluating and accounting for litigation, claims and assessments. The auditor also may need to request additional information from the Federal reporting entity, or DOJ or other outside legal counsel, to obtain evidence about the completeness assertion. Such requests to DOJ or other outside legal counsel should be made through management of the Federal reporting entity. Further, the auditor should consider whether the audit scope is limited by the inability to obtain sufficient competent evidential matter regarding the completeness assertion for litigation, claims and assessments.

References

Interpretation of Federal Financial Accounting Standards No. 2,
Accounting for Treasury Judgment Fund Transactions

Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*

AICPA Codification of Statements on Auditing Standards, AU Section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments*; and Auditing Interpretations of AU Section 337

Federal Financial Accounting And Auditing Technical Release 2: Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government

Status

Issued	March 15, 1998
Effective Date	For fiscal periods beginning after September 30, 1997
Volume II References	Cleanup Costs (C40), Liabilities (L40)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 12: definitional change for “probability”.• SFFAS 11: rescinded Federal Mission PP&E

Summary

Agencies that must deal with environmental contamination should first refer to the hierarchy of accounting standards contained in the current Office of Management and Budget (OMB) Bulletin on “Form and Content of Agency Financial Statements” for guidance. Standards issued by Government Accountability Office (GAO) and OMB have precedence over other authoritative guidance for federal entities. This technical release supplements the relevant federal standards, but is not a substitute for and does not take precedence over the standards.

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Introduction

Federal agencies are required to recognize a liability when a future outflow or other sacrifice of resources as a result of past transactions or events is “probable” and “reasonably estimable.” This technical release is intended to assist federal agencies in determining probable and reasonably estimable liabilities related to their environmental cleanup responsibilities.

Agencies that must deal with environmental contamination should first refer to the hierarchy of accounting standards contained in the current Office of Management and Budget (OMB) Bulletin on “Form and Content of Agency Financial Statements” for guidance. Standards issued by Government Accountability Office (GAO) and OMB have precedence over other authoritative guidance for federal entities. This technical release supplements the relevant federal standards, but is not a substitute for and does not take precedence over the standards.

This technical release includes two sections and an appendix. Section 1 will help an agency determine whether its environmental contamination meets the definition of probable (i.e., a future outflow of resources will be required to clean up the contamination). Section 2 offers guidance in quantifying an agency’s liability for cleanup. Appendix I lists key laws and regulations relating to environmental contamination.

Scope

This technical release offers guidance based on *Statements of Federal Financial Accounting Standards* (SFFAS), and draws on information from other literature. The applicable federal standards are:

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*
SFFAS No. 5, *Accounting for Liabilities of the Federal Government*

SFFAS No. 6¹ addresses cleanup costs from federal operations known to result in hazardous waste. SFFAS No. 6 provides guidance when cleanup occurs at the end of the useful life of the property, plant, and equipment (PP&E) or at regular intervals (scheduled phase cleanup) during that life.

¹The recognition and measurement provided in SFFAS #6 are subject to the criteria for recognition of liabilities included in SFFAS #5. That is, liabilities shall be recognized when the following conditions are met:

- a past transaction or event has occurred,
- a future outflow or other sacrifice of resources is probable, and
- the future outflow or sacrifice of resources is measurable.

SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, applies to all environmental liabilities not specifically covered in SFFAS 6, including cleanup resulting from accidents or where cleanup is an ongoing part of operations².

Section 1: Determining “Probable” Environmental Liabilities

Description of Issue

An agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable.³ Concerns have been raised about when costs associated with environmental damage meet the **probable** and reasonably estimable criteria. **Probable** is related to whether a future outflow will be required.⁴ This section addresses only the “**probable**” part of this requirement; reasonably estimable will be addressed in Section 2.

²In the case of cleanup as an ongoing part of operations [i.e., the operation or activity generates hazardous waste that is cleaned up as it is created (e.g., hospitals regularly dispose of hazardous materials)], a liability may not need to be recognized if the need to cleanup and the full cleanup occur in the same reporting period. However, the total cost of cleanup should be recognized in the period the cleanup need arises. Refer to footnote 15 for further information.

³This Release generally discusses “sites” or “contamination” when referring to environmental contamination. However, property, plant and equipment that requires cleanup (because of damaging the environment when being used or at time of disposal) is included in the scope. A further discussion of issues related to PP&E, including recognizing a liability for PP&E already in service, is included in Section 2 under the heading “Guidance for Active Sites.”

⁴This Release uses SFFAS No. 5’s definition of “**probable**,” which is “**more-likely-than-not**” (see par. 33 of SFFAS No. 5). This Release applies the contingent liability criteria (i.e., probable, reasonably possible, and remote) from SFFAS No. 5 to all environmental liability estimates, whether or not they meet the criteria (see par. 36 of SFFAS No. 5). [See SFFAS 12 regarding the definition of probable.]

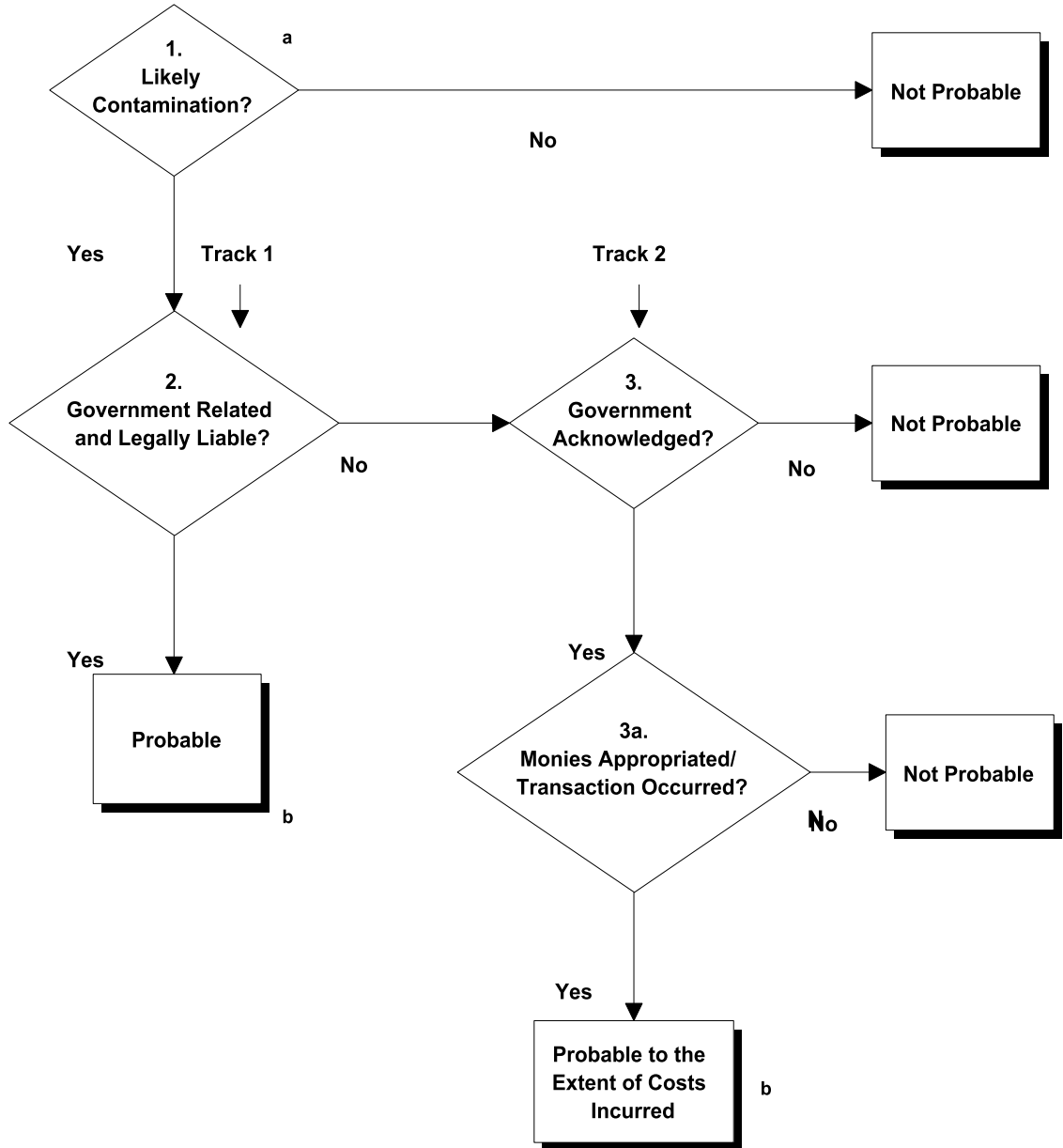
Key Determinants and Positions

Various key factors (tests) must be considered in determining whether a future outflow of resources from a federal agency for environmental cleanup is **probable**. The factors are:

1. Likely Contamination,
2. Government Related and Legally Liable,
3. Government Acknowledged Financial Responsibility,
 - 3a. Monies Appropriated/Transaction Occurred, and
4. No Known Remediation Technology Exists.

Diagram 1.1 illustrates the above tests. These tests for probability assume that a past transaction or event has occurred (i.e., past or present operation, contribution and/or transportation of waste), and apply to both active and closed sites. A narrative discussion of each of these tests for probability follows on Diagram 1.1.

Diagram 1.1: Determination of Probable Environmental Liabilities



^a See discussion on “due care”.

^b If *no known technology exists*, then it would be probable to the extent of any required study costs, costs associated with containment, or any other monies obligated or spent. However, given that the actual remediation is not feasible, the actual remediation costs would not meet the probable criteria.

Diagram 1.1 shows that there are two primary tracks for determining whether a federal agency's environmental responsibilities meet the [probable](#) criterion. The first track is when contamination is known, is related to federal government operations, and represents a legal liability. The second track is when the federal government knows of contamination, and although the contamination is not government related and the government is not legally liable, the government acknowledges financial responsibility for cleanup. For both tracks, if no known technology exists, then the probability criterion is met only to the extent of likely expenditures (e.g., for study costs and containment). A more detailed discussion of the various components of Diagram 1.1 follows.

1. **Likely Contamination:** If the agency has exercised due care in determining the presence of contamination and as a result, believes it is unlikely that contamination (for which it is responsible) exists, then the probability criterion is not met. However, if the relevant agency is aware of contamination, having used the due care criteria (see below), then the agency must determine whether the contamination is government related and the federal government (i.e., the agency) is legally liable.

Due care refers to a reasonable effort to identify the presence or likely presence of contamination. Due care is considered to be exercised if an agency has effective policies and procedures in place to routinely attempt to identify contamination and forward that information to the responsible agency official. Procedures that are evidence of the exercise of due care may include, but are not limited to, the following:

- review of recorded chain-of-title documents (including restrictions, covenants and any possible liens) and good faith inquiry and investigation into prior uses of the property;
- investigation of aerial photographs *that are available through government agencies* that may reflect prior uses;
- analyses to estimate the existence of uninvestigated sites based on information from known sites;
- inquiry into records *that are available* from federal, state, and/or local jurisdictions that show whether there has been a release or potential release of hazardous substances on the property (and adjacent property, if suspected contaminators exist);
- visual site inspection of any portions of the property where environmental contamination is likely or suspected, and

- investigation of complaints regarding abnormal health conditions.
2. **Government Related and Legally Liable⁵:** As it relates to environmental damage/contamination, government related events are those where a governmental entity either *caused* contamination (i.e., contribution of waste) or is otherwise related to it in such a way that it is legally liable to clean up the contamination. If the agency believes it is more likely than not that it will be legally liable, then the probability criterion is met.⁶
 3. **Government Acknowledged Financial Responsibility:** If environmental contamination is not government related, then the agency, under its statutory programmatic authority, must determine whether it is authorized to formally accept financial responsibility for cleanup.⁷ If the government does not accept financial responsibility, then the probability criterion is not met.
 - 3a. **Monies Appropriated/Transaction Occurred:** If an agency accepts financial responsibility under No. 3 above,⁸ then the agency determines the extent of probability based on appropriation or authorization legislation and whether a transaction has occurred causing another party to expect

⁵Legally liable is defined, generally, as any duty, obligation or responsibility established by a statute, regulation, or court decision, or where the agency has agreed, in an interagency agreement, settlement agreement, or similar legally binding document, to assume responsibility for cleanup costs. Legal liability should be determined in consultation with the entity's legal counsel. [See American Bar Association's (ABA) Statement of Policy Regarding Lawyers Responses to Auditors' Request for Information (December 1975). Also see American Institute of Certified Public Accountants (AICPA) Professional Standards, Auditing Standards (AU) Section 337C – source SAS No. 12.]

⁶Federal entities should consider the Environmental Protection Agency's (EPA) National Priorities List [which identifies "potentially responsible parties" (PRP)] when determining probability.

⁷"The Federal government has broad responsibility to provide for the public's general welfare. The Federal government has established programs to fulfill many of the general needs of the public and often assumes responsibilities for which it has no prior legal obligation." Statement of Federal Financial Accounting Standards No. 5, ¶ 30.

⁸This Release does not propose a position regarding environmental contamination caused by natural disasters which may become the responsibility of the Federal Emergency Management Agency's (FEMA).

payment (e.g., contractor has performed cleanup of a site). For example, if the federal government has acknowledged responsibility for cleaning up a site, the cost of which is at \$10 million, and \$2 million has been appropriated but only \$1 million in services have been rendered, probable is only met to the extent of \$1 million. In the case of government acknowledged events, both conditions (i.e., appropriations or authorization and transaction executed) must exist for the probability criterion to be met.

4. **No Known Remediation Technology Exists:** In the case of a government related event, where there is no known technology to clean up a particular site, then known costs, for which the entity is responsible, such as a remedial investigation/feasibility study (RI/FS) and/or costs to contain the contamination, meet the probability test. With no known remediation technology, actual remediation is not feasible and therefore the outflow of resources for remediation is not probable.

Section 2: Determining “Reasonably Estimable” Environmental Liabilities

Description of Issue

An agency is required to recognize a liability for environmental cleanup costs resulting from past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. Concerns have been raised about *when* costs associated with environmental damage meets the probable and reasonably estimable criteria. Reasonably estimable relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required. This section addresses only the

“reasonably estimable” part of this requirement; probable was addressed in Section 1.⁹

Key Determinants and Positions

Various key factors (tests) should be considered in determining whether future outflows of resources can be reasonably estimated. The factors are:

1. Completion of a Remedial Investigation/Feasibility Study (RI/FS)¹⁰ or other Study,
2. Experience with Similar Site and/or Conditions, and
3. Availability of Remediation Technology.

These tests for reasonably estimable are applied after a transaction or event has occurred that meets the definition of “probable” as discussed in Section 1; tests apply to both active and closed sites. The analysis should consider all significant sites, with the information rolled up into an entitywide estimate. Cost estimates should be based on current technology. Diagram 2.1 on page 1247 illustrates the application of these tests. A discussion of each of the three tests follows Diagram 2.1. The discussion concludes with issues related to quantification of the estimate and guidance for active sites. Overall, it must be emphasized that every effort should be made to develop an estimate.

⁹Disclosure requirements when the criteria for reasonably estimable are not met are as follows:

- the nature of the environmental damage and
- an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.

¹⁰A remedial investigation/feasibility study (RI/FS) is a comprehensive environmental data collection and site characterization study (RI) that evaluates alternative cleanup actions and recommends one (FS).

Diagram 2.1: Determination and Quantification of Reasonably Estimable Environmental Liabilities

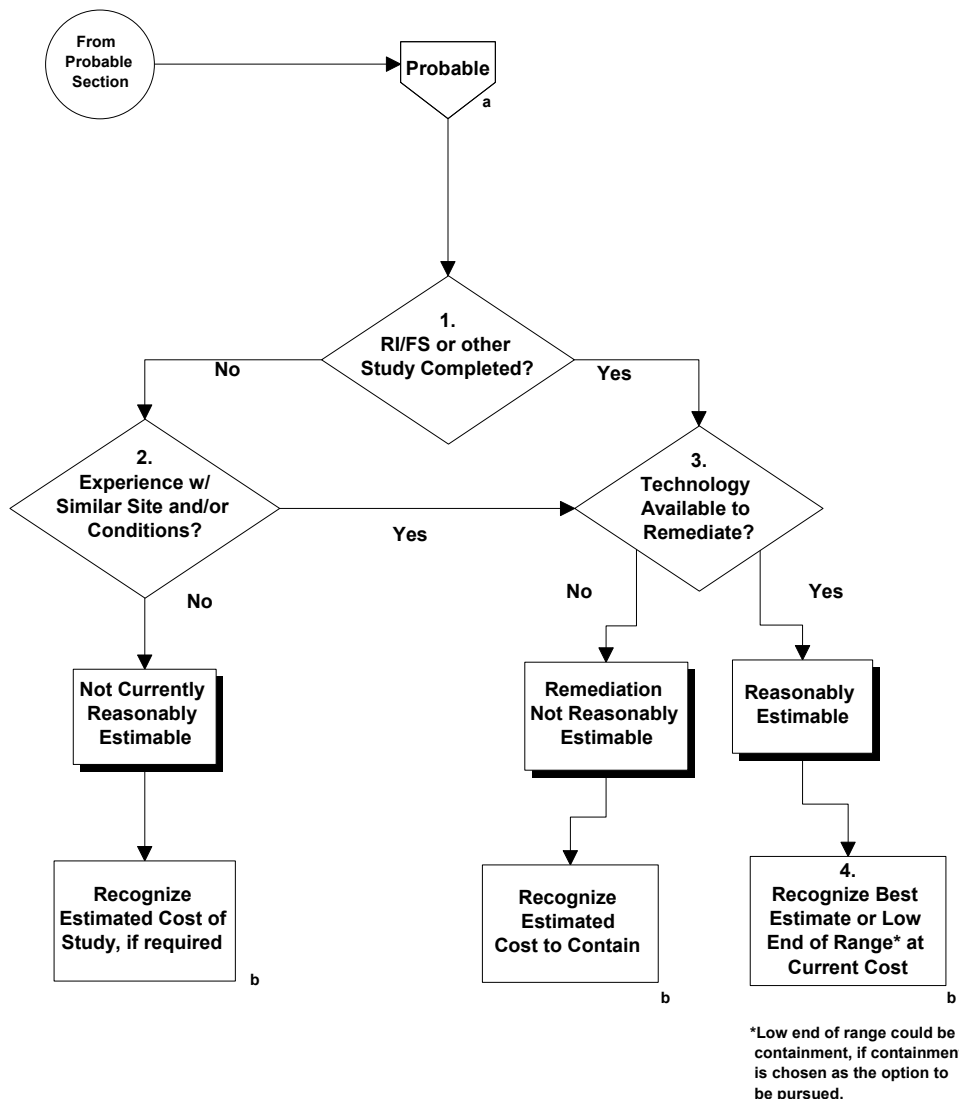


Diagram 2.1 begins with the assumption that costs associated with environmental damage has already met the test for probable. This is a direct continuation of the left-side track of Diagram 1.1 on the definition of

probable (i.e., the agency has met probable under government related and is legally liable; see Section 1). As it relates to the “probable” second track (i.e., government acknowledged), probable is only met to the extent that monies have been appropriated or authorized (through authorization legislation) and costs have been incurred (e.g., services rendered). In these situations, a definitive dollar figure has already been determined and an estimate is not required. Therefore, the following discussion refers to determining whether something is “reasonably estimable” only as it relates to government related and legally liable.

1. **Completion of RI/FS or other Study:** The first test in determining whether costs are reasonably estimable is to ascertain whether there is a completed study upon which to base an estimate. For example, if a remedial investigation/ feasibility study (RI/FS) has been completed for a particular site, the RI/FS would form the basis upon which to begin estimating the liability.

The fact that an agency does not have a *departmentwide* comprehensive study completed does not exempt an agency from making its best effort to estimate a liability for financial statement purposes, or for recognizing a liability for that portion of its obligation that can be estimated.

If the results of the study indicate that no contamination exists, then probability is not met and the decision process of Diagram 2.1 should be considered complete.

2. **Experience With Similar Site and/or Conditions:** If no study has been completed, the next test is to determine whether a site appears to be similar to any other site or condition where experience has been gained through either a completed study or actual remediation. Similar sites or conditions could be related to other federal entities or private sector corporations. A “site” is defined as a physical place where contamination has occurred. A “location” can be composed of many sites; a site can contain many “conditions.” It may be practical for an agency to combine similar conditions or sites into one large site or location.

If there is a similar site or condition with experience gained (through actual cleanup and/or a completed study to compare), the estimate for recognizing a liability for a site could be based on the similar experience or conditions. In addition, the estimated cost of a future

study (if required) should be recognized. Future studies could result in improved estimates.

If there is no comparable site and/or condition, remediation costs for a site would not be considered reasonably estimable at that time, but the agency would recognize the anticipated cost of conducting a future study, if required, plus any other identifiable costs.

3. **Availability of Remediation Technology:** Assuming a study has been completed, or an agency or other entity has experience with a similar site and/or condition as noted above, the next test is whether there is technology available to remediate a site. If no remediation technology exists, then remediation costs would not be reasonably estimable, but the agency would be required to recognize the costs to contain the contamination and any other relevant costs, such as costs of future studies.

If technology is available, then remediation costs are reasonably estimable, and the agency would recognize the best estimate at current cost. If no amount within a range of estimates is a better estimate than any other amount, the minimum amount in the range would be recognized. If the estimate is based on similar site criteria, the agency would also recognize the anticipated cost of its own RI/FS or other study, if required.

In certain instances, the RI/FS or other study may conclude that even though technology *does* exist to remediate, containment should be considered as one of the options by the agency. If the agency has yet to make a decision and they may in fact choose containment rather than remediation, and assuming containment is not precluded by other involved parties (i.e., by EPA, individual states and/or local jurisdictions), the agency would consider the estimated cost of containment when calculating the estimated costs to be recognized or disclosed. The agency would calculate an amount to be recognized based on the type and length of containment required.¹¹

If management has not determined what remedial action should be taken for a contaminated *active* site, the cost of containment at the end of the facility's useful life, plus the cost of a study, if not yet done, should be considered as the low end of the range of future estimated cleanup costs.

4. **Quantification of the Estimate:** According to paragraph 39 of the SFFAS No. 5 on contingent liabilities, the estimated liability may be a specific amount or a range of amounts.¹² If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized. According to SFFAS No. 6, ¶ 95, estimated costs should be based on the cleanup plan, assuming current technology and current cost.

Changes in environmental liability estimates related to PP&E should be accounted for in accordance with SFFAS No. 6. For general PP&E, SFFAS No. 6 requires that the portion of the re-estimate related to current and prior periods be recognized as an expense in the period of the change. For stewardship PP&E, SFFAS No. 6 requires that the change in estimate be expensed for the incremental costs identified in the reestimate and the liability adjusted in the period of the change.

Where an agency is one of several potentially responsible parties (PRP's) under CERCLA and management has determined that more likely than not the agency is legally liable, the agency should include an estimated liability for its:

- (1) allocable share of the liability for a specific site, and

¹¹RCRA (Resource Conservation and Recovery Act) regulations require owners of hazardous waste disposal facilities to implement post-closure maintenance and monitoring activities for a minimum of 30 years. When developing estimates of these operation and maintenance (O&M) costs, EPA generally assumes that O&M activities will be required for 30 years. In most instances, containment costs should be determined on the basis of a minimum of 30 years. It would be expected that in the case of nuclear contamination, different tri-party agreements, technical problems, or other circumstances may lead to the use of a substantially longer time frame than for typical RCRA or CERCLA (Comprehensive Environmental Response Compensation and Liability Act of 1980) sites.

¹²This Release uses SFFAS No. 5's definition of "probable," which is "more likely than not" (see par. 33 of SFFAS No. 5). This Release applies the contingent liability criteria (i.e., probable, reasonably possible, and remote) from SFFAS No. 5 to all environmental liability estimates, whether or not they meet the criteria (see par. 36 of SFFAS No. 5).

-
- (2) share of amounts related to the site that will not be paid by other PRP's.¹³

If an agency shares responsibility with nongovernmental PRP's for a government related event, the agency should recognize the share that management believes it is more likely than not the agency is legally liable for.¹⁴ Where the federal government shares responsibility with nongovernmental PRP's and agency management has decided to accept the nongovernmental PRP's share of the responsibility for the damage (i.e., a government acknowledged event), the agency would *also* recognize a liability for the PRP's share once the criteria of appropriation or authorization legislation and a transaction have occurred, causing another party to expect payment (e.g., contractor has performed site cleanup).

Guidance for Active Sites

Thus far, this technical release has dealt with costs for *past* environmental contamination of property, plant, and equipment (PP&E) related to active and closed sites. In addition, SFFAS No. 6 outlines accounting treatment for *future* environmental contamination of PP&E at active sites. The following shows how environmental cleanup costs¹⁵ for active sites should be recognized for general and stewardship PP&E under SFFAS No. 6.

General PP&E

There are two implementation methods for general PP&E in service at the effective date of the standard. Under the first method, the agency would estimate the total cleanup costs (based on current cost to perform the

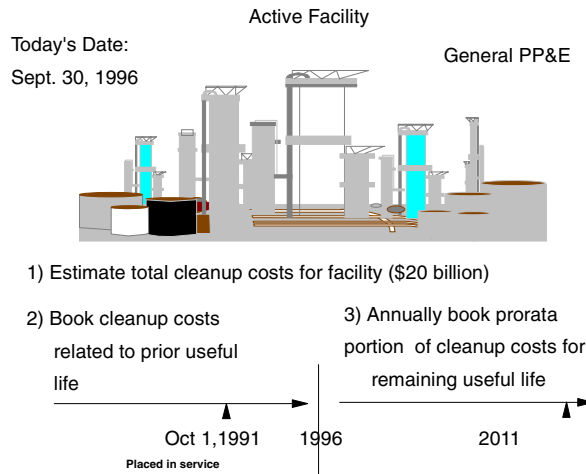
¹³AICPA Statement of Position (SOP) 96-1, *Environmental Remediation Liabilities*, page 43 par. 6.2.

¹⁴If management determines that an agency should assume responsibility for a portion of another PRP's share of the liability, the agency may recognize a receivable from the other PRP when the federal entity establishes a claim to cash or other assets against the other PRP based on the related legal provisions (i.e., a legal instrument, such as a settlement agreement, or other objective, verifiable information). Losses on receivables should be recognized when it is more likely than not that the receivables will not be collected in total.

¹⁵Costs referred to in this section are for decontamination and decommissioning (D&D) only, not operating costs. D&D costs are those incurred after plants or equipment become inactive and require cleanup. Operating costs are period costs that flow through the *Statement of Operations and Changes in Net Position*. A liability is not recognized for operating costs.

cleanup¹⁶) that will be required at the end of the PP&E's useful life. The agency would recognize the estimated cost as a prior period adjustment for the portion of the total estimated cleanup costs related to that portion of the PP&E's useful life that has already expired.

To illustrate, assume implementation of SFFAS No. 6 on October 1, 1996. Using the illustration below, and assuming a facility was placed in service at the beginning of fiscal year 1992 with a 20-year useful life, the agency would first estimate the total costs (based on current cost) required to clean up the contaminated facility at the presumed plant closure at the end of fiscal year 2011 (\$20 billion). From that estimate (as of October 1, 1996), the amount that relates to that portion of the PP&E's useful life that has already expired (4/20 of \$20 billion, or \$4 billion) would be charged to net position and the fiscal year 1996 prorata portion would be charged to expense.



Beginning with fiscal year 1997, the agency would annually recognize a prorata portion of the estimated total cleanup costs based on the remaining useful life of the subject PP&E. In our example, for fiscal year 1997, for this plant (with an estimated remaining useful life of 15 years), the agency would recognize 1/15 of the total estimated remaining cleanup cost of \$15 billion, or \$1 billion. The probable criterion was met under Diagram 1.1 once the PP&E was placed in service. The reasonably estimable criterion

¹⁶Current cost should be based on existing laws, technology and management plans (SFFAS No. 6, paragraph 188).

was met with the agency's development of an overall estimate of total cleanup costs using the process indicated in Diagram 2.1. Consequently, each year's allocation of cleanup costs is both probable and reasonably estimable, thus requiring the agency to recognize a liability. The allocation method used for cleanup costs, as described above, is similar to depreciation of general PP&E.

Changes in estimates of cleanup costs should be accounted for in accordance with the SFFAS No. 6, which requires that the cumulative effect of changes in total estimated cleanup costs related to current and past operations be recognized as expense, and the liability adjusted in the period of the change in estimate.

SFFAS No. 6 allows a second method for recognizing cleanup cost related to general PP&E in service at the effective date of the standard. The alternative method provides that "if costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total [ultimate] cleanup cost as a liability upon implementation of the standard."¹⁷

For general PP&E placed in service after the effective date of the standard, the agency should estimate the total cleanup costs¹⁸ related to the PP&E and recognize annually a prorata portion of the costs over the life of the asset. Expense recognition shall begin on the date that the PP&E is placed into service.

Because contaminate land does not have a useful life and is not depreciated, it should be treated the same as the facility that is located on the land. For land contaminated in the past, a liability should be recognized for the total estimated cleanup costs. For land expected to be contaminated in the future due to ongoing operations, a portion of estimated total cleanup costs shall be recognized as expense during each period that the associated general PP&E is in operation. If no facility is associated with the land, the

¹⁷SFFAS No. 6 paragraph 104

¹⁸According to SFFAS #6 paragraph 95 the estimate shall contemplate:

- the cleanup plan, including
 - level of restoration to be performed,
 - current legal or regulatory requirements, and
 - current technology; and
 - current cost which is the amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current period.

land should be treated as stewardship PP&E. SFFAS No. 6 provides guidance for stewardship PP&E (see the following paragraph for a brief summary of stewardship PP&E).

Stewardship PP&E

Stewardship PP&E includes [federal mission PP&E](#)¹⁹, heritage assets, and stewardship land. For stewardship PP&E *already in service*, according to SFFAS No. 6, on the day the standard is adopted or upon early implementation, the agency would charge net position through a prior period adjustment and recognize a liability for the full amount of the estimated ultimate cleanup costs. For new stewardship PP&E, the agency would recognize an expense and a liability for the total amount of estimated ultimate cleanup costs when the PP&E is placed in service. As with general PP&E, the probable criteria would be determined under Diagram 1.1 at the time the standard is adopted or new PP&E is placed in service. Likewise, the reasonably estimable criteria for the total ultimate cleanup costs would be determined based on Diagram 2.1. However, unlike general PP&E, stewardship PP&E is fully expensed once acquisition costs are incurred. SFFAS No. 6 calls for the entire ultimate cleanup costs to be expensed when the PP&E is placed in service.

¹⁹The FASAB is currently developing an exposure draft that proposes to change the term “federal mission PP&E” to “national defense PP&E” and to alter the definition. [SFFAS No. 11]

Appendix I - Relevant Laws

This appendix lists some of the laws that relate to environmental cleanup. It is not intended to be a comprehensive list of all pertinent laws. Federal agencies should check with their Office of General Counsel to determine which laws are applicable to their agency.

I. Principal Environmental Laws to Which Federal Facilities Are Subject

- A. Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA, or Superfund), and subsequent amendments
 - 1. Administered by EPA
 - 2. Established a program to identify sites (National Priorities List)
 - a. Typically abandoned or inactive sites
 - b. Can be applied to sites still in operation
 - 3. Set up trust fund to cover costs (with attempts to recover)
 - 4. Detailed standards for remediation and settlement provisions and authorized criminal sanctions
 - 5. Entities may have “joint and several” liability for cleanup
- B. Resource Conservation and Recovery Act (RCRA)
 - 1. Permits issued by EPA for facilities used or being used to manage hazardous waste (includes generating, treatment, storage, and disposal)
 - 2. Covers both closed and active facilities
- C. Clean Air Act
- D. Clean Water Act

II. Other Environmental Laws

- A. Safe Drinking Water Act
- B. Toxic Substances Control Act
- C. Federal Insecticide, Fungicide, and Rodenticide Act
- D. Pollution Prevention Act 1990
- E. Federal Facilities Compliance Act
- F. Nuclear Regulatory Act and its amendments
- G. Emergency Planning and Community Right-to-Know Act

IV. State laws

- A. For federal cleanup activities, state standards can apply, which are at least as stringent as federal laws

V. Foreign Laws

Federal Financial Accounting And Auditing Technical Release 3 (Rescinded): Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act

Status

Issued	July 31, 1999
Effective Date	For fiscal periods beginning after September 30, 1998
Volume II References	Loans and Loan Guarantees (L60)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	Technical Releases 3-Revised and 6 rescinds Technical Release 3 in its entirety.

Federal Financial Accounting and Auditing Technical Release 3 (Revised): Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – *Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*

Rescinding Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*

Status

Issued	January 2004
Effective Date	Immediately
Volume II References	Loan and Loan Guarantees (L60)
Interpretations and Technical Releases	Technical Release 6: Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>
Affects	Technical Release 3: <i>Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>
Affected by	None.

Summary

This technical release amends the guidance for auditors to audit credit subsidy estimates provided in Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (TR3), July 1999. The original technical release (July 1999) contained both audit and accounting guidance. Technical Release 6 contains only the guidance for preparing estimates.

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Introduction

1. The purpose of this technical release is to amend the guidance for auditors to audit credit subsidy estimates provided in Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act (TR3), July 1999. The original technical release (July 1999) contained both audit and accounting guidance. The most significant changes made in this amended TR 3 are 1) the removal of the preparation guidance from this amended TR to only include the audit guidance and 2) procedural changes updating the document to reflect new guidance and changes in terminology in the area of credit reform (e.g., SFFAS 18 & 19; and OMB Circular A-11). Concurrent with the issuance of this amended technical release on auditing guidance, Technical Release 6 is being issued and will contain only the guidance for preparing estimates.
2. Readers of this technical release should first refer to the hierarchy of accounting standards in Statement on Auditing Standards (SAS) 91, Federal Generally Accepted Accounting Principles Hierarchy (or see AU411).
3. This technical release includes sections on:
 - Planning the Credit Subsidy Audit
 - Testing Internal Control
 - Substantive Testing of Subsidy Estimates
4. It also presents four appendices on:
 - Acceptable Sources of Documentation for Subsidy Estimates and Reestimates
 - Technical Glossary
 - Summary of Reestimate Requirements
 - Summary of Reporting Requirements
5. This technical release does not address loan asset sales and does not provide complete guidance for administrative expenses and pre-1992 direct loans and loan guarantees. Guidance on these areas can be found in SFFAS Nos. 2, 18, & 19 and OMB Circular No. A -11 and OMB Bulletin No. 01-09. Additional guidance on loan asset sales will be addressed separately in the future.

Background

6. This technical release is designed to provide guidance on the audit of credit subsidy estimates. There are three parts of subsidy: initial subsidy, modifications of subsidy and reestimates of subsidy. This technical release discusses audit methods, both internal control and substantive procedures, that may be used to audit credit subsidy estimates, modifications and reestimates. As complex and varied as credit subsidies are within Government, auditor judgment is essential to implementing this guidance. This technical release also provides guidance on acceptable sources of documentation for subsidy estimates and reestimates.

Accounting and Budgeting Guidance

7. Federal agencies are required to account for direct loans and loan guarantees in accordance with Statement of Federal Financial Accounting Standards No. 2, Accounting for Direct Loans and Loan Guarantees (SFFAS No. 2), SFFAS No. 18, Amendments to Accounting Standards for Direct Loans and Loan Guarantees, and SFFAS No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees.
8. OMB Circulars A-11 *Preparation, Submission, and Execution of the Budget* and A-129 *Policies For Federal Credit Programs and Non-Tax Receivables* provide guidance to agencies on definitions, procedures and rules for calculating subsidy estimates and reestimates for the President's Budget and modification cost estimates, obligation of budget authority for the credit program's cost, and credit and receivables policy.
9. The Credit Subsidy Calculator (CSC) is a computer program provided to the agencies to calculate the cost of direct loans and loan guarantees using the agencies' cash flow estimates. The OMB Circular A-11 requires that all agencies with credit programs must use the CSC to discount the credit subsidy estimate and reestimate cash flows that they are responsible for generating.

Materiality

10. The provisions of this guidance need not be applied to immaterial items.

Effective Date

11. The guidance outlined in this technical release is effective immediately.

Audit Tests for Direct Loan and Loan Guarantee Subsidy Estimates

12. The overall purpose of auditing the subsidy estimation and re-estimation process is to provide reasonable assurance that the reported credit program receivables and related foreclosed property and related allowance for subsidy, liabilities for loan guarantees, and subsidy expense, are reasonably stated in the financial statements and provide reliable and useful information for decision makers. Since the audit should be conducted in three phases—planning, internal control, and substantive testing—this technical release is organized in the same way. Due to the complexity of credit subsidy estimates, thorough planning is key to an effective and efficient audit. The auditor must also assess the agency's internal control and the risk of errors and irregularities that may cause a material misstatement in the financial statements. Based on this assessment, the auditor can determine the nature, timing, and extent of substantive testing to determine whether the credit subsidy estimate is reasonable in the context of the financial statements taken as a whole.

Planning the Credit Subsidy Audit

13. The audit of credit subsidy estimates should be considered in conjunction with other audit areas, e.g., claims, insurance in force, foreclosed property, premium receipts, and loan sales. In this way, the auditor will be able to leverage off the other audit areas to maximize audit efficiency and effectiveness. When planning the audit of credit subsidy estimates, the auditor must consider the budget preparation process, which generally occurs during the same time as the planning phase, and the impact audit adjustments may have on the budget submission. When planning the nature, timing, and extent of the audit of credit subsidy estimates, the auditor is encouraged to perform the review and testing of the cash flow models, as described throughout this section, early in the audit process. By performing these audit procedures early in the agency's audit, any necessary adjustments to the cash flow model can also be made in time to be included in the budget cash flow model. In this way, the audit of the credit subsidy estimates will fulfill the intent of paragraph 17 in SFFAS No. 2 which states that "The Board recognizes the value of having financial accounting support the budget. It endorses the logic underlying credit reform, and it recommends that accounting standards for credit be

consistent with budgeting under credit reform.” Auditors are encouraged to use their judgment when determining the nature, timing, and extent of tests that will be performed. Not all of the tests contained in this Technical Release will be applicable to all credit programs.

Understanding the Credit Subsidy Estimate Process

14. During the planning phase, the auditor should focus on four primary objectives: (1) understanding the agency's credit subsidy estimate process, (2) identifying key estimate assumptions, (3) identifying material and high risk credit programs, and (4) assessing inherent risk and the effects of information technology on inherent risk.
15. Without a thorough understanding of the agency's credit subsidy estimate process, the auditor is unable to efficiently and effectively audit the loans receivable and the related allowance, the liability for loan guarantees, and the subsidy expense, in accordance with applicable auditing standards. To gain an understanding of the credit subsidy process, the auditor should
 - a. Review the documented subsidy estimation procedures to gain an understanding of the process, including the types of underlying data used to develop cash flow assumptions, key formulas used in cash flow worksheets, and the person responsible for each phase of the process.
 - b. Identify significant external and internal factors that may affect the credit subsidy process. External factors may include economic conditions, current political climate, and relevant legislation. Internal factors may include the size of the agency's budget and accounting staff, qualifications of key personnel, turnover of key personnel, and systems capabilities.

- c. Develop a high-level understanding of the agency's use of information technology, how information technology affects the subsidy estimate process, and which systems should be included with the general and application control review.¹
 - d. Determine, with the assistance of a systems audit specialist as necessary, whether systems-related controls are likely to be effective.² If controls are not likely to be effective, the auditor should determine the impact on control risk, appropriately adjust substantive testing, and focus on testing the effectiveness of manual controls during the internal control phase of the audit.
16. The auditor may gather planning information through different methods such as observing agency operations, interviewing agency staff, reviewing procedures manuals, and conducting walk throughs. In addition, the auditor may gather information from relevant reports, including prior year financial statements, Federal Managers' Financial Integrity Act (FMFIA) reports and supporting documentation, Inspector General and internal audit reports, and congressional hearings and reports.

Identifying Key Assumptions

17. One way for the auditor to maximize audit efficiency is to focus on the key assumptions, i.e., those assumptions that have the greatest impact on the credit subsidy rate and hence, the credit subsidy amount. To identify key assumptions, the auditor should evaluate and retest selected areas of management's credit subsidy sensitivity analysis. For example, in performing this analysis, agency management may have varied the subsidy estimate assumptions by a fixed amount, such as 10 percent in either direction, and was thus able to identify the

¹ The auditor should actively coordinate general and application control reviews of financial management systems to ensure that they focus on controls over key cash flow reports such as defaults or prepayments as well as the controls over the cash flow spreadsheets. Further, the auditor should consider evaluating controls over the agency's use of the OMB Credit Subsidy Calculator. For a detailed discussion of the audit procedures related to the OMB Credit Subsidy Calculator, refer to the Report of Independent Accountants and Independent Verification and Validation (Y2K) Documents Pertaining to the Credit Subsidy Calculator, available on OMB's Federal Credit Support Page prepared by the Budget Analysis Branch: <http://www.omb.gov/credit>. These audit procedures have been included in this technical release in summary form.

² Although the actual testing of technical system-related controls should generally be performed by a systems audit specialist, the financial statement audit team should participate in identifying and testing general controls, user controls, and application controls to tentatively conclude on the effectiveness of systems-related controls.

degree to which the subsidy rate was sensitive to different assumptions. These assumptions often require greater audit effort because minor variations may have material effects on the subsidy amount. The auditor should review this sensitivity analysis carefully and retest selected portions as necessary to gain comfort with management's work before relying on it. In resetting the agency's sensitivity analysis, the auditor should consider recalculating the impact that changes in key assumptions have on a credit program's subsidy amounts.

18. When identifying key assumptions, additional consideration should also be given to those assumptions that fluctuate significantly. These assumptions may be more difficult to predict, and their normal fluctuation may materially affect the credit subsidy amount even though the credit subsidy amount may not change significantly during the sensitivity analysis. For example, prepayments may be difficult to predict since historically they fluctuated ten percent or more over the past five years. Thus, even though the auditor did not identify prepayments as a key assumption during the review of the agency's sensitivity analysis, prepayments should be considered a key assumption because their normal fluctuation may materially affect the credit subsidy amount.
19. If management has not performed sensitivity analysis of the credit subsidy assumptions, the auditor may consider performing a sensitivity analysis or other analysis to identify the key cash flow assumptions. This analysis will allow the auditor to focus on key areas and will increase the auditor's efficiency in the substantive testing phase of the audit.
20. In order for the auditor to maximize efficiency and effectiveness when selecting programs for internal control testing and substantive testing, the auditor should focus efforts on material programs. Generally, material programs have higher inherent risk than immaterial programs. Materiality is defined in Financial Accounting Standards Board Statement of Financial Concepts No. 2, Qualitative Characteristics of Accounting Information, as "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." Thus, items of little importance are less likely to affect the financial statement

Identifying Material and High Risk Credit Programs for Internal Control and Substantive Testing

users' judgment. Materiality has both qualitative and quantitative factors, since certain types of relatively immaterial misstatements from a quantitative standpoint could be significant for other reasons. For example, some programs that are immaterial in amount could be sensitive because of Congressional interest.

21. According to Statement on Auditing Standard 47, AU Section 312, Audit Risk and Materiality in Conducting an Audit, "audit risk and materiality, among other matters, need to be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures." The following list includes some of the factors that the auditor should consider in determining which direct loan or loan guarantee programs are material and/or high risk and therefore should be selected for testing.

- The amount of subsidy expense for a given program,
- The dollar value of the program's direct loans on the balance sheet,
- The dollar value of the program's loan guarantees and their related liability for default,
- The dollar amount of subsidy expense, magnitude of transactions, and variance of past reestimates,
- Past audit experience for the program,
- The auditor's preliminary assessment of risk,
- Recent significant changes in economic conditions,
- The complexity of the program (the number, size, and technical difficulty of the loans),
- The age of the program (new programs may have more risk than older established programs, other things being equal),
- The degree to which sub-recipients, contractors, and private lenders make decisions about implementing the program, and
- Congressional and other public policy interest in a given program.

22. This list is designed to assist the auditor in identifying material and/or high-risk programs. The above list is not designed to replace professional judgment. For example, a credit program could have a relatively small subsidy expense because the agency nets gross subsidy expense components with offsetting fees, in accordance with SFFAS No. 2 and the Credit Reform Act. However, the auditor should not focus solely on the net subsidy expense. Rather, the auditor

should consider the gross amounts of the subsidy expense and fees, the total loans receivable, and/or the total liability for loan guarantee account when determining whether the program is material.

23. Past audit experience should be considered since it may indicate that the program should be retested again this year when, for example, significant internal control weaknesses were discovered in the prior year's audit. Conversely, past audit experience may allow the auditor to reduce the level of current year testing for the program. Factors that should be considered in determining the appropriate level of detailed substantive testing for material programs include:
- The number of years since the last time the program was included in internal control and substantive testing,
 - The results of the preliminary assessment of risk,
 - Changes in economic events that affect the current cash flow assumptions,
 - The level of employee turnover, and
 - Changes in program characteristics, terms of credit, or implementation.
24. Finally, when inherent risk is low and the agency's control environment is strong, the auditor may consider testing credit programs on a rotating basis. In determining whether rotational testing is appropriate, the auditor should consider (1) the results of prior audit experience, (2) the length of time since the program was tested, (3) the materiality of the program, and (4) the auditor's assessment of inherent and control risk.
25. Upon completion of the internal control testing, the auditor may wish to revise the assessment of which programs are material and/or high risk. For example, the auditor's preliminary risk assessment may not be supported by the results of the internal control testing. When the results of the internal control testing lead the auditor to conclude that the internal control is not operating effectively, the auditor may revise the risk assessment for programs originally expected to have low risk. As a result, the auditor should include these programs in the detailed substantive testing. On the other hand, the auditor may decide to reduce the extent of detailed substantive testing for a material program based on the results of internal control testing.

Assessing Inherent Risk and
the Effects of Information
Technology

26. Based on the auditor's understanding of the credit subsidy estimation process, the auditor identifies specific inherent risks³ and control environment weaknesses. To identify inherent risk factors, the auditor generally focuses on (1) the nature of the agency's program, (2) prior history of audit adjustments, and (3) the nature of material transactions. The nature of an agency's program may increase inherent risk. For example, some loan guarantee programs may be more susceptible to errors because of loans issued and serviced by third parties. Significant audit adjustments in previous audits often identify problem areas that may continue to result in financial statement misstatements. Accounts involving subjective management judgments, such as credit subsidy estimates and the liability for loan guarantees, are usually higher risk than those involving objective determinations.
27. Information Technology can also introduce inherent risk factors. The auditor should assess systems-related factors and determine the overall impact of information technology on inherent risk. For example, unusual or non-routine transactions generally increase inherent risk. Programs or systems developed to estimate credit subsidy amounts, e.g., the agency's cash flow spreadsheets, may not be subjected to the same procedures and controls as EDP programs and systems developed to process routine transactions. The degree of existence and completeness of the audit trail may also increase inherent risk. The audit trail demonstrates how a specific transaction was initiated and processed. Some EDP financial management systems are designed so that the audit trail exists only for a limited period, only in electronic format, or only in summary form. Uniform processing of transactions may also increase inherent risk because a programming error will consistently misstate transactions. For example, if an agency misstates a cash flow assumption, such as defaults, recoveries, or the interest rate, in a cash flow spreadsheet that has been electronically linked to other cash flow spreadsheets, the error will affect all of the linked cohorts or programs. As a result, the auditor must be aware that some errors may be systemic rather

³ Inherent risk is the susceptibility of a financial statement assertion to a material misstatement, assuming that there are no related internal controls. Financial statement assertions are representations by management that are embodied in financial statement components. See Codification of Statements on Auditing Standards, AU Section 326.

than isolated incidents and the auditor should be careful to distinguish between the two.

Testing Internal control

28. As noted above, the auditor should select material programs for internal control and detailed substantive testing. In this way, the auditor will more effectively and efficiently focus audit efforts on the programs that are most significant to the users of the financial statements. In some instances, more than one program will utilize the same system of internal control. Thus, the auditor would need only test the system once to gain assurance on all related programs. This section provides guidance for the auditor to use in evaluating the agency's internal control for material and/or high-risk credit programs so that the auditor can determine the nature, timing, and extent of substantive tests to perform on credit reform related accounts such as subsidy expense, allowance for subsidy, and liabilities for loan guarantees. The auditor needs to evaluate the agency's internal control before updating the preliminary assessment of the control risk.⁴
29. Due to the complexity of credit reform, it is necessary for the auditor to obtain a good understanding of the internal control components to design effective substantive tests. If, after evaluating the agency's internal control, the auditor assesses control risk at a high level, the auditor will need to obtain most, if not all, of the audit assurance from substantive tests. Thus, the auditor will need to expand the level of detailed substantive testing. However, if the auditor determines that control risk is low based on the evaluation of the agency's internal control, the auditor has more assurance concerning the accuracy of the information generated within that structure. Thus, the auditor may be able to reduce the level of detailed substantive testing.

⁴ Control risk is the risk that a material misstatement could occur in a financial statement assertion and will not be prevented, detected, and corrected on a timely basis by the entity's internal control structure.

Assessing the Control Environment

30. Internal control is a process--affected by an agency's management⁵ and other personnel--to provide reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, control activities, information and communication, risk assessment, and monitoring. The auditor should consider the following when obtaining an understanding of the agency's internal control.
31. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing the discipline and structure. When assessing the control environment, the auditor should consider management's philosophy and operating style (done elsewhere in the audit) and generally perform the following steps for the material programs' systems of internal control.
- a. Determine whether the same estimation process was used for other programs by comparing the documented procedures between programs. If the same process was used between programs, the results of the internal control testing for this program may help the auditor gain comfort with other programs.
 - b. Determine how management assures itself that established procedures and internal control have been consistently implemented among the various divisions/branches responsible for preparing subsidy expense estimates.
 - c. Determine how management assures itself that the historical data used as the basis for the subsidy amounts accurately supports the cash flow assumptions.
 - d. Determine whether the agency has the appropriate supporting documentation for key assumptions as outlined in Appendix A of this technical release.
 - e. Determine how management assures itself that assumptions or data requirements which are based on conditions affecting multiple programs and cohorts are uniformly applied. For

⁵ In this technical release, the term "agency management" is used in the same context as it is used in OMB Circular A-123 and may include any individual Federal manager responsible for ensuring that credit reform is implemented efficiently and effectively to achieve intended program results. Agency management could include, but is not limited to, the Chief Financial Officer, Director of Budget, and Controller.

example, identify and test the controls in place that management relies on to ensure that:

- Similar assumptions are made concerning economic conditions for a particular business sector where both direct and guaranteed credit programs are delivered,
 - Historical data for subsidy expense components are consistently collected and interpreted among similar programs, and
 - Options chosen for the OMB Credit Subsidy Calculator properly reflect the specific characteristics of the applicable credit program.
- f. Review management's comparison of projected cash flows to actual cash flows from the accounting department. Determine whether management (1) appropriately identified material variances and the cause of these variances, (2) performed trend analysis of the credit subsidy components, (3) adjusted future cash flow estimates of those cohorts to reflect these variances, (4) determined whether there was a flaw in the cash flow spreadsheet that caused the variance and, if so, determined the impact this flaw had on all cohorts, and (5) reestimated subsequent years' subsidy amounts, as appropriate.
- g. Determine whether the agency is appropriately using the latest version of the OMB Credit Subsidy Calculator by recalculating the subsidy rate with the agency's estimated cash flows.⁶
- h. If applicable, determine whether waivers were obtained from OMB for years in which subsidy reestimates were not performed in accordance with OMB guidance.
- i. Determine how management assures itself that the agency used the proper scale for the cash flow spreadsheets. Some program subsidy rates, particularly those for programs disbursing over several years, may be influenced significantly by the scale for cash flow values. Therefore, management should determine whether an appropriate scale has been used so that rounding to three decimal places has no significant effect on the cash flow spreadsheet values and the subsidy rate.
- j. Determine how management assures itself that the agency has appropriately prepared cash flows using a cohort basis or disbursement year basis. For example, when a program

⁶ A copy of the model is available from OMB's Budget Analysis Branch.

disburses over more than one year, the auditor should determine whether the agency used a disbursement year basis. If the agency used a cohort basis, the auditor should determine why the agency did not use a disbursement year basis and whether the use of cohort level cash flows has had a material effect on the subsidy calculation. If the effect is material, the auditor should recommend that the agency prepare cash flows on a disbursement year basis to eliminate the problem.

- k. Determine whether agencies have controls over access to the OMB Credit Subsidy Calculator, e.g., confirmation of passwords, and determine whether these controls adequately protect the model from unauthorized use and corruption.

Control Activities

32. Control activities are the policies and procedures designed to ensure that management directives are carried out. Control activities have various objectives and are applied at various organizational and functional levels. Control activities can include physical controls, segregation of duties, performance reviews, and information processing. When assessing management's assignment of responsibility and delegation of authority for ensuring the efficient and effective implementation of credit reform, the auditor should consider doing the following.

- a. Assess management's control methods for monitoring and following up on the agency's ability to prepare reliable subsidy estimates by reviewing, on a test basis for material programs, management's comparison of projected net cash flows with actual cash flows to determine whether over time projected cash flows are becoming more representative of actual cash flows and whether reestimates are the result of controllable factors (technical cash flow assumptions) or uncontrollable factors (discount rate assumptions).
- b. Verify that the cash flow assumptions that the agency used in developing its cash flow estimates were reviewed and approved by the appropriate agency management.
- c. Determine how management assures itself of the reliability and logic flow in formulas and mathematical functions within agency initial cash flow worksheets.
- d. Assess the internal control used by management to ensure that changes made to cash flow spreadsheet formulas are appropriate. For example, if changes made to one cash flow spreadsheet need to be carried forward to other spreadsheets, determine whether

this is done automatically or if each spreadsheet must be updated individually. Assess the risk of errors being introduced during this process.

- e. Determine whether management has a systematic process in place to identify significant changes in economic or other assumptions that will affect subsidy rates of existing cohorts. Determine whether management has a systematic process in place to calculate the differences between actual and estimated cash flows and the possible effect of these differences on the future cash flows of existing cohorts. Determine whether this process assesses the materiality of these changes on the cash flow estimates and the subsidy expense and appropriately concludes whether reestimates are required under OMB guidance. In evaluating potential changes in cash flow assumptions, the process should assess the impact that various factors may have on the program (which also may affect subsidy rates), such as:
- Legislative program changes,
 - Administrative program changes,
 - Environmental changes,
 - Operational changes, e.g., a reduction in employees because of budgetary constraints that would impact the servicing of loans,
 - War, and
 - International economic factors.
- f. Determine how management assesses the impact of changes in laws or regulations on the reliability of estimates. For example, a legislative program change may include provisions about maturity or type of borrowers that are outside the scope of past agency experience or may include program changes that shift the composition of new lending toward more or less risky borrowers. Stratification of the portfolio by risk category may enable management to assess the effect of the changes on the estimates. If the agency's databases do not permit such stratification, the uncertainty associated with the estimates may increase.
- g. Determine whether management has a systematic process in place to estimate the effect of the factors considered in paragraph (e) above on the cash flows of new cohorts.

Information and
Communication

33. Once specific controls related to the above activities have been identified, additional tests should be designed to ensure that the agency's controls are operating as designed. The auditor should consider using dual purpose testing to combine the internal control testing with substantive testing as appropriate. Dual purpose testing is discussed in more detail in the section on substantive testing of subsidy estimates in this technical release.
34. The quality of system-generated information affects management's ability to prepare reliable financial reports. Communication involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. The auditor should obtain an understanding of (1) the classes of transactions in the agency's operations that are significant to credit reform accounting in accordance with Treasury case studies, (2) how those transactions are initiated, (3) the accounting records, supporting information, and specific accounts in the financial statements involved in the processing and reporting of the transactions, (4) the accounting process involved from the initiation of a transaction to its inclusion in the financial statements, and (5) the financial reporting process used to prepare the agency's financial statements, including significant accounting estimates and disclosures. When assessing controls over information and communication, the auditor should consider doing the following:
- a. Identify and test the controls in place designed to ensure that appropriate personnel are made aware of any concerns that result from reviewing key cash flow assumptions and comparing estimated to actual cash flows as well as the actions taken to resolve the concerns and update the subsidy estimate as appropriate.
 - b. Determine whether internal control are in place to ensure that the data supporting the cash flow identifiers⁷ used in the spreadsheets are appropriate and consistent with the description of the identifier contained in the applicable user's guide of the

⁷ Cash flow identifiers are listed in the document, "How to organize cash flow estimates in a spreadsheet file," which is available on the Federal Credit Support Page (<http://www.omb.gov/credit>). The document includes various elements the agency must consider when estimating net cash flows, such as disbursements, principal payments, interest payments, fees and other income, defaults, etc.

OMB Credit Subsidy Calculator. Effective internal control are needed to ensure that disclosures concerning the amount of subsidy expense related to interest differential (direct loans), interest supplement (loan guarantees), defaults (net of recoveries), fees, and other are reasonable. For example, the auditor should identify and test controls designed to ensure that the amount estimated for recoveries is based on reliable, complete information from the agency's past experience. For example, the auditor should also identify and test controls designed to ensure that, when compiling the information upon which the estimate is made, transactions have been properly classified as a recovery rather than a reduction in the amount of another cash identifier such as "defaults" or "losses other than default."

- c. Determine whether controls are in place to ensure that all applicable credit program cash flows are addressed in the subsidy estimation process. For example, cash flows should be estimated for all transaction types that affect Standard General Ledger Account nos. 1399, Allowance for Subsidy, and 2180, Loan Guarantee Liability. Conversely, transactions in unrelated accounts should be excluded from the subsidy calculation. To test these controls, the auditor should consider reviewing the cash flow worksheet input and the program description to determine whether all applicable cash flow types have been included. In addition, the auditor should review the transaction types included in the Allowance for Subsidy and the Liabilities for Loan Guarantees accounts on a test basis to determine whether these transactions are appropriate.

Risk Assessment

35. The risk assessment process is an internal process used by the agency to (1) identify and analyze the relevant risks to achieving its objectives and (2) develop a plan to mitigate the identified risk. The auditor should obtain sufficient knowledge of the agency's risk assessment process to understand how management identifies, evaluates, and mitigates risks relevant to developing reliable credit subsidy estimates. In evaluating the risk assessment process, the auditor should determine if management developed a strategic plan with goals and objectives for ultimately improving the reliability of estimates. The auditor should determine whether this plan addresses (1) clearly defining the data requirements, (2) developing an effective information store and modeling methods as described in issue paper 96-CR-7 Model Credit Program Methods and Documentation for

Estimating Subsidy Rates and the Model Information Store, available from the AAPC web page (<http://fasab.gov/aapc/cdreform/othercrddoc.htm>), (3) improving the methods of estimating cash flows, and (4) step-by-step resource allocations and target completion dates to meet the goals and objectives of the strategic plan. Also the auditor should assess management's progress at meeting the plan's goals and the targeted completion dates.

Monitoring

36. Management should monitor controls to determine whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring is a process that assesses the quality of internal control performance over time. OMB Circular A-123, Management Accountability and Control, is issued under the authority of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 and provides guidance to federal managers on improving the accountability and effectiveness of federal programs and operations by establishing, assessing, correcting, and reporting on management controls. During federal financial statement audits, the auditor is required to assess the agency's compliance with the FMFIA. The auditor should obtain sufficient knowledge of the major types of activities the entity uses to monitor internal control over financial reporting, including how those activities are used to initiate corrective actions. When assessing control risk, the auditor should be cognizant of any material weaknesses reported in the agency's FMFIA report that relate to the efficient and effective implementation of credit reform.

Substantive Testing of Subsidy Estimates

37. Agencies are required by SFFAS No. 2 to account for subsidies at the cohort level in their accounting systems. This information is then aggregated for inclusion in the financial statements. As previously noted, footnote information related to credit programs is typically reported at the fund or program level and the total subsidy expense for the year is divided among three categories: the current year's direct loans or loan guarantees, modifications, and reestimates. The subsidy expense for the current year's direct loans or loan guarantees is segregated into four categories consisting of interest differential or supplement, defaults, fees, and other. The auditor needs to gain assurance about these cost categories at the aggregated fund/program level; however, it is difficult for the auditor to apply adequate procedures for summary amounts which represent numerous cohorts.

It would be difficult to explain variations in aggregated amounts without addressing the more detailed cohort level. Determination of what level to disaggregate subsidy information for the purposes of an audit will vary for each agency and will be contingent on current practice and available information.

General Approach to Substantive Testing

38. The following four steps provide a general approach for performing substantive testing. Detailed guidance on implementing these four general steps follows. The nature, timing, and extent of substantive tests will be significantly influenced by the auditor's assessment of the internal control environment. **This section is written under the premise that the agency has established effective internal control.** The next section includes a discussion of the impact of ineffective controls on the nature, timing, and extent of substantive testing as well as the impact on the audit opinion.
- a. Select a representative sample of cohorts for detailed testing, for those material programs selected for internal control testing.⁸
 - b. Test sampled cohort estimates to determine whether the credit reform process is working as defined and whether the account balance is reasonably stated.
 - c. Perform analytical review procedures to gain assurance that the estimates are reasonable for lines of business, funds, programs, or cohorts not selected for detail testing.
 - d. Conclude on audit differences identified during the test work and determine the financial statement impact.

Impact of Ineffective Internal control on Substantive Testing

39. The auditor's assessment and conclusions regarding the effectiveness of the agency's internal control structure, including computer security and the effectiveness of edits and other system controls, will significantly impact the level of substantive testing. If the agency's internal control structure is not effective (i.e., does not adequately reduce the risk that a material misstatement related to credit reform in the financial statements would be detected and corrected), the auditor will need to design substantive tests to gain assurance on the account balance and propose audit adjustments as necessary.

⁸ Professional standards stated in AU Section 350.24 that "sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected."

40. For example, if there is no system in place to trigger reestimates, the auditor will need to review management's comparison of actual cash flows for material programs to projected cash flows to search for and identify material variances. In addition, the auditor will need to determine whether the agency identified other factors that may materially affect future cash flows, e.g., economic downturn, program changes, or drought, and may require a reestimate. If the budgeted to actual cash flow comparison was not done by the agency, the auditor should consider performing this analysis based on resource availability. Based on the auditor's analysis of the identified variances and other changes that may affect future cash flows, the auditor should determine whether a reestimate is necessary and urge the agency to calculate the reestimate. Once the reestimate is made, the auditor is then able to assess the impact of the reestimate on the financial statements.
41. If in the auditor's opinion (1) the internal control weaknesses are so significant that the subsidy expense is likely to be materially misstated, (2) resource constraints make it unreasonable for the auditor to conduct the level of substantive testing necessary to determine the possible audit adjustments, or (3) resource constraints at the agency make it unreasonable to calculate all the necessary material reestimates and include them in the financial statements, the auditor would likely be required to modify the audit opinion. For example, the monitoring process to determine whether reestimates are necessary is a key internal control. Without effective monitoring, the agency may not have reasonable assurance that material reestimates will be made timely and the auditor would need to expand the level of substantive testing. When an agency does not (1) reestimate credit subsidies for the most recently completed fiscal year and include the reestimate in the current year's financial statements or (2) provide assurance that there is no material financial statement impact (as specified in TR 6 paragraphs 47 – 58), the auditor should consider modifying the audit opinion.
42. When assessing the financial statement impact of subsequent events related to credit subsidies, the auditor should follow the guidance in AU Section 342.13 for events occurring after the reestimate date but before the end of fieldwork. In addition, auditors should consider AU Sections 508.19 and .29 - .32 when assessing the effect of uncertainties on the agency's financial statements and the auditor's opinion.

Selecting the Sample of Cohorts

43. The procedures for selecting a sample of cohorts depend upon the type of information to be gleaned from the sample and the desired precision of sample estimates. The sampled cohort is tested to determine whether the credit reform process is working as defined and more specifically, whether the related balance sheet and statement of net cost line items are reasonably stated. In order to gain audit efficiencies, the auditor should consider utilizing dual purpose testing⁹ for a representative sample of cohorts selected from material credit programs. In this way, the auditor will be able to gain assurance from the same sample that both the internal control structure is effective and that the account balance is reasonably stated in relation to the financial statements taken as a whole. When more than one program utilizes the same system of internal control, the auditor should only test the system once to gain assurance on all related programs and their cohorts. To utilize representative sampling, the auditor must select sample items in such a way that each item in the population has an opportunity to be selected and the estimators are appropriate for the selection methods. In this way, the sample and the resulting estimate or projection are expected to be representative of the population from which the sample was selected. In addition, sufficient sample sizes are necessary in order for the auditor to arrive at meaningful conclusions.
44. The auditor may wish to stratify the population of cohorts into homogeneous groups prior to selecting the sample to improve sampling efficiency. For example, the auditor may stratify the cohort population into the following three significant groups: (1) material cohorts of such a magnitude that the auditor will test them all, (2) material cohorts that the auditor will sample for testing, and (3) immaterial cohorts that will be subjected to analytical review procedures. For some agencies, the small number of cohorts may prohibit using this sampling approach. In these instances, the auditor should focus on selecting a representative sample in a nonstatistical manner, i.e., using auditor's judgment to select material cohorts for testing to obtain sufficient coverage of the balance being audited or doing a 100 percent sample.

⁹ Dual purpose testing often improves audit efficiency by performing multiple audit procedures on a single sample, e.g., internal control attribute and substantive testing.

45. Alternatively, when the agency's control environment is strong and inherent risk is low, the auditor may test cohorts on a rotating basis. In determining whether rotational testing is appropriate, the auditor should consider (1) the results of prior audit experience, (2) the length of time since the cohort was tested, (3) the materiality of the cohort in terms of the relative effect of the cohort on total program expenditures or the size of the program in absolute dollars, and (4) the auditor's assessment of inherent and control risk. The auditor may wish to score these factors in determining the cohort's relative risk. Based on the cohort's score, the auditor may establish a rotation matrix for substantive testing. For example, all cohorts above a predetermined score would be considered high risk and selected for substantive testing while other cohorts below this score could be tested on a rotating basis.

Testing Sampled Cohorts

46. Professional standards call for the auditor to "analyze historical data used in developing the assumptions to assess whether the data are comparable and consistent with data of the period under audit, and consider whether such data are sufficiently reliable for the purpose."¹⁰ In the planning phase, the auditor identified the key assumptions as those whose variation had the greatest impact on the subsidy rate or which varied significantly. Based on this work, and the results of the internal control analyses, the auditor should be able to focus on the key assumptions. However, these key assumptions may be tested in conjunction with the audit of other financial statement line items. For example, the default rate assumption for guaranteed loans can be tested as part of the audit of claim payments, recovery rate assumptions can be tested during the audit of foreclosed property, fees can be audited in conjunction with insurance premium or other cash receipts, and prepayments can be audited during the audit of insurance in force. In these cases, the auditor must carefully plan the audit samples for these areas in order to include information that will be applicable to the credit subsidy audit and gather sufficient evidence for the auditor to determine the reasonableness of the credit subsidy. For example, when auditing credit subsidy default, prepayment, and recovery assumptions, it is important to determine for which cohort the claim payment was made.

¹⁰ Codification of Statements on Auditing Standards, AU Section 342, Auditing Accounting Estimates.

47. The following are examples of the types of tests the auditor can perform on a representative sample of cohorts selected for dual purpose testing:
- a. Collect projected cash flow worksheets used for budget execution and the most recent reestimates for each cohort selected for testing to determine whether the program assumptions are utilized at the cohort level. Trace and compare key cash flow assumptions to the agency's supporting data, including reports on defaults, prepayments, recoveries, etc.
 - b. Verify the reliability of the data used in developing the assumptions and ensure that key assumptions are sufficiently reliable by
 - Comparing the reports to similar reports tested in related audit areas to assess consistency and
 - Tracing summary reports to historical supporting documentation, on a test basis, to determine whether the reports are complete and accurate.
 - c. Determine whether management used reasonable and systematic methods to project key cash flow assumptions by reviewing, assessing, and recalculating, on a test basis, key portions of the cash flow worksheets.
 - d. Based on the results of system-related control tests, the auditor should consider obtaining an appropriate, unmodified version of the OMB Credit Subsidy Calculator, downloading the agency's cash flows into this version, and comparing the output to the agency's subsidy calculation. In performing these procedures, it is important for the auditor to use the same cash flows as those used to calculate the subsidy rate. Thus, the auditor should verify that the file name, range name, and the date and time the spreadsheet was last changed matches the information on the model output. If differences are identified through this comparison, the auditor should consider recalculating the subsidy rate using the agency's data and an appropriate copy of the model.¹¹ Differences between the auditor's recalculated rate and the agency's rate should be investigated and explained.
 - e. The auditor should review the OMB Credit Subsidy Calculator output to determine whether any warning messages are listed

¹¹ A copy of the model is available on OMB's Federal Credit Support Page (<http://www.omb.gov/credit>) or from OMB's Budget Analysis Branch.

- and, if so, to determine why the situation causing the warning message was not resolved and whether not eliminating the error could have any impact on the subsidy rate calculation. Also, if applicable, auditors should determine whether the suppression of any error messages was appropriate by checking the agency's cash flow spreadsheet to determine whether the "suppress warnings" command was used and assess the impact these suppressed error messages could have on the subsidy rate.
- f. The auditor should determine whether the OMB Credit Subsidy Calculator options that were selected properly reflect specific characteristics of the applicable credit program. For example, the OMB Credit Subsidy Calculator options for the timing of principal and interest payments for direct loan programs and the timing of commitments and disbursements by the private lender of a loan guaranteed should agree with the program's credit terms.
 - g. Verify that reestimates were performed under the conditions specified in Technical Release 6. Determine whether reestimates were performed in addition to those required in Technical Release 6. For example, reestimates required for budgetary purposes may not be material to the financial statements.
 - h. Determine that these reestimates were completed, included in the financial statements, and submitted to OMB.
 - i. Determine whether the re-estimation process included adjustments to subsequent years' estimates of cash flows for this cohort.
 - j. Determine why reestimates were not calculated¹² and included in the financial statements, if applicable. When reestimates are not prepared for the most recently completed fiscal year, the agency must document the reason for forgoing the reestimate otherwise required in Circular A-11 and SFFAS No. 2 and provide the necessary supporting documentation to OMB and the auditor. The documentation should address the requirements prescribed in Technical Release 6.

¹² OMB has established a four-step process, outlined in Circular A-11, for agencies to calculate technical reestimates for the budget less often than every fiscal year—subject to OMB approval. However, this guidance does not allow agencies to omit material technical reestimates from the current year financial statements or to postpone including material technical reestimates in the financial statements until a subsequent year. Conversely, the OMB process may require agencies to make technical reestimates for the budget that are not material to the financial statements.

- k. Trace interest rates to approved OMB rates to ensure that interest expense and income are calculated in accordance with OMB Circular A-11.
- l. Determine if the reestimates recorded in the accounting records were submitted to OMB.
- m. Determine whether modifications occurred as defined in SFFAS No. 2 and OMB Circulars A-11 and whether the modification cost was estimated.
- n. Verify whether the cash flows and discount rates used to calculate the pre-modification and post-modification values of the direct loans (or values of the loan guarantee liability) were determined appropriately.
- o. Verify whether the modification cost was submitted to OMB, recorded in the accounting records, and included in the financial statements.

Analytical Review Procedures

- 48. Analytical review procedures can be performed on lines of business, funds, programs, or cohorts not selected for detailed testing. Generally, these procedures consist of comparing recorded balances of subsidy expense, fund balance with Treasury, debt owed to Treasury, credit program receivables and related foreclosed property, and the liabilities for loan guarantees, with the auditor's expectations. The basic premise of analytical review procedures is that plausible relationships among data may be expected to continue unless conditions are known that would change the relationship. Based on the results of the analytical review procedures outlined below, some programs may be selected for detail substantive testing. In applying analytical review procedures, the auditor should consider the following procedures.
 - a. Based on the information gathered during the internal control phase of the audit, including the auditor's understanding of the estimation process and economic events affecting the period under review, develop an expectation or estimate of what the recorded amount should be. For example, the auditor could compute an estimate of the subsidy expense by using averages as an overall test of reasonableness, i.e., average loans outstanding, average interest rate, average default rate, and average fees. Compare the results of the auditor's estimate to the actual recorded balance to identify significant differences that require investigation. When making estimates of an account balance, the auditor should assess the reliability of the data used and the

impact faulty data could have on the auditor's expectation of the subsidy amount.

- b. Compare the subsidy amounts for lines of business, funds, programs, or cohorts not selected for sampling for three or more years to identify trends and significant fluctuations in the subsidy rates.
- c. Obtain explanations for these fluctuations from management to determine whether the fluctuations are reasonable. Scan¹³ cash flow worksheets/reports to search for unusual items and investigate significant fluctuations.
- d. Corroborate management's explanations as necessary. Corroboration generally consists of reviewing related supporting documentation or obtaining explanations from accounting or budget personnel or from the appropriate program department. These explanations should be quantified and address the direction and magnitude of the event causing the fluctuation.
- e. If the explanation and/or corroborating evidence do not adequately explain the fluctuation, the auditor should consider
 - Increasing the precision in the auditor's expectations,
 - Increasing the extent of detailed testing for the cohorts discussed above and not relying on the analytical procedures, or
 - Treating the difference as a misstatement.
- f. Review and recalculate selected portions of the agency's trend analysis of the credit subsidy expense components to determine whether the agency identified and explained unusual or significant fluctuations in interest, defaults, fees, and other. If the agency has not done the credit subsidy component trend analysis, the auditor should consider performing this analysis. Once unusual or significant fluctuations have been identified, the auditor should obtain and corroborate management's explanation.

Compliance with Laws and Regulations

49. By using the audit approach described in this technical release, the auditor will test compliance with the Federal Credit Reform Act of

¹³ Although scanning is not usually considered an analytical procedure on its own, this technique could be used to investigate unusual fluctuations in subsidy amounts or corroborate management's explanation of variances between projected cash flows and actual cash flows.

1990, as amended. Thus, no separate audit procedures are necessary to test compliance with this act.

Concluding on the Reasonableness of Estimates

50. Statement on Auditing Standard No. 57 Auditing Accounting Estimates, AU 342, states that the auditor evaluates the reasonableness of accounting estimates in relationship to the financial statements taken as a whole. It goes on to state:

“Since no one accounting estimate can be considered accurate with certainty, the auditor recognizes that a difference between an estimated amount best supported by the audit evidence and the estimated amount included in the financial statements may be reasonable, and such difference would not be considered to be a likely misstatement. However, if the auditor believes the estimated amount included in the financial statements is unreasonable, he should treat the difference between that estimate and the closest reasonable estimate as a likely misstatement and aggregate it with other likely misstatements. The auditor should also consider whether the difference between estimates best supported by the audit evidence and the estimates included in the financial statement, which are individually reasonable, indicate a possible bias on the part of the entity's management. For example, if each accounting estimate included in the financial statements was individually reasonable, but the effect of the difference between each estimate best supported by the audit evidence was to increase income, the auditor should reconsider the estimates taken as a whole.”

51. Uncertainties, among other qualitative aspects of information in financial reports, are discussed in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, Objectives of Federal Financial Reporting. According to SFFAC No. 1, "Reliability [of financial information] does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured." Thus, an amount reported in the financial statements may be "fairly stated," but still imprecise. In addition, SFFAC No. 1 states that "Financial reporting may need to include narrative explanations about underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all." In other words, imprecision of accounting estimates can be overcome, to some extent, by appropriate financial statement disclosures. In determining whether (1) the credit program receivables and related foreclosed property and the liabilities for loan guarantees line items on the balance sheet, (2) the subsidy expense included in the statement of net costs, and (3) related footnote disclosures regarding credit reform are reasonably stated, the auditor must evaluate and carefully consider all

of the audit evidence gathered, including the results of the internal control testing, system reviews, detailed substantive testing, analytical review procedures, as well as the above authoritative guidance.

Appendix A: Acceptable Sources of Documentation for Subsidy Estimates and Reestimates

52. Documentation must be provided to support the assumptions used by the agency in the subsidy calculations. This documentation will not only facilitate the agency's review of the assumptions, a key internal control, it will also facilitate the auditor's review. Documentation should be complete and stand on its own, i.e., an independent person could perform the same steps and replicate the same results with little or no outside explanation or assistance. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purposes of reconstructing the estimate.

53. Management should ensure that the following documentation is available for initial subsidy estimates, reestimates, and modifications of existing credit programs:
 1. Procedures for calculating the subsidy estimate,
 2. Review and approval process of the subsidy estimate, including the sign-off procedure within the agency,
 3. Calculation of the recorded subsidy estimates, including the underlying assumptions and cash flow model,
 4. Historical supporting documents used in the underlying assumptions,
 5. Documentation of relevant supporting actual cash and economic experience (including the date and source of reports, and how recently the data were updated), which may include:
 - Cash reports on historical performance,
 - Historical data and trends, citing sources of information and relevant time frame,
 - Sensitivity analysis or other analysis that identifies the most critical factors,
 - Reports from the accounting or management systems showing trends
 - Actuarial studies,
 - Experience of other agencies with similar programs,
 - Emergencies (acts of God) or legislated changes (acts of Congress), such as changes in the program terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population, and

- Economic and/or industry data and subsequent analyses, including industry studies, journal articles, trade papers, and third party studies.¹⁴
6. Documentation of relevant program design factors, which may include:
- Program definition including fees, grace period, term to maturity, borrower interest rates, legal definitions, and enabling or enacted legislation,
 - Legislation or regulations changing the terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population,
 - Program eligibility requirements,
 - Lender agreements detailing the terms of the guarantee, and
 - Borrower contracts outlining the terms and conditions of the loan or guarantee.
54. Management should ensure that the following documentation is available for new programs or changes to existing programs that may not have historical supporting documentation for cash flow assumptions and spreadsheets. In the absence of valid and relevant historical experience as the support for cash flow assumptions, the agency should document the basis for cash flow assumptions. Typical support will include:
- Relevant experiences from other agencies, including documentation of why another agency's experience is relevant, as well as similarities and differences (particularly possible biases) between the other agency's experience and the changes to existing programs or new programs,
 - Extrapolation from subsets of prior program activity, e.g., while prior loans were not targeted for single heads of households, it may be possible to identify prior loans that were made to single heads of households and the experience of such loans in prior records.
 - Assumptions used by underwriters for the purposes of determining eligibility, loan approval, or credit scoring.

¹⁴ For example, past data may document the historical relationship between interest rates, whereas an independent study may demonstrate how trends in past data are expected to change in the future.

- Private sector proxies for risk, such as bond ratings to assess default risk, may be used when there is no relevant Federal Government experience. For example, an agency may consider using bond ratings for a state agency that finances similar loan programs, such as education, farm, or housing, with bonds.
- Extrapolations from private sector lending experience including documentation explaining why this experience is applicable to the agency's credit program and possible biases for which an adjustment is needed, e.g., different borrower characteristics.
- Expert opinion may also be used as an interim measure to support cash flow assumptions. In these cases, the agency must document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis of the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:
 - Memos from conversations with outside experts,
 - Reports and studies on similar industry conditions,
 - Minutes from internal meetings describing the basis for any assumptions or changes in assumptions, and
 - Previous studies conducted by the expert, including industry studies, journal articles, and third party studies.

Appendix B: Technical Glossary

Allowance for Subsidy See Direct Loan Subsidy Allowance Account definition.

Assumptions basic beliefs about the future operating and functional characteristics of the loan or group of loans or loan guarantees. Types of assumptions include:

Cash flow assumptions- all known and/or forecasted information about the characteristics and performance of a loan or group of loans or loan guarantees. Examples include estimates of loan maturity, borrower interest rate, default/delinquency rate, timing of defaults, overall impact of changes in economic factors, etc.

Model assumptions - determinations of how cash flow assumptions are applied through the life of the cohort. For example, determining whether the entire assumed amount of defaults should be applied in 1 year or whether a constant or variable proportion of the assumption value should be allocated to each year. The allocation of cash flows over time is the selected model form and is just as influential as the cash flow assumptions.

Case level each individual loan or guarantee within a cohort.

Cash flow stream the agency's projection of the dollar amount for the scheduled cash flows and deviations from scheduled cash flow items for each year over the life of the cohort.

Cash flows Estimates of payments to or from the Government over the life of a loan or group of loans or loan guarantees. For direct loans, these may include: loan disbursements, repayments of principal, payments of interest, and any other payments such as prepayments, fees, penalties, and other recoveries. For loan guarantees, these may include: payments by the Government to

cover defaults and delinquencies, interest subsidies, payments to the Government, such as origination and other fees, penalties and recoveries, and any other payments.

Cohort

all direct loans or loan guarantees of a program for which a subsidy appropriation is provided for a given fiscal year, even if disbursements occur in subsequent years. For direct loans and loan guarantees for which a subsidy appropriation is provided for one fiscal year, the cohort will be defined by that fiscal year. For direct loans and loan guarantees for which multi-year or no-year appropriations are provided, the cohort will be defined by the year of obligation.

Direct Loan Subsidy Allowance Account

the balance maintained in the general ledger that represents the difference between the current outstanding loans receivable balance and the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the direct loans. The subsidy allowance is subtracted from the loans receivable balance when calculating the net loans receivable balance. A similar account may also be used for defaulted guaranteed loans.

Econometrics

the application of statistical methods to the estimation of economic relationships.

Financing Account

the non-budgetary account or accounts associated with each credit program account that holds 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. Each program account is associated with one or more financing accounts, depending on whether the account makes both direct loans and loan guarantees (separate financing accounts are required for direct loans and loan guarantees).

Fund

an aggregation of programs into a common grouping consistent with how the Congress provides appropriations - i.e., the program and financing accounts together and, if needed, the negative subsidy receipt accounts. (This term has other meanings in different contexts.)

Inputs	in the context of Federal credit, cash flow data elements used to develop spreadsheet calculations.
Internal control	an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, risk assessment, control activities, information and communication and monitoring.
Key assumptions	assumptions that have been established, through sensitivity analysis or other means, to be the elements that have a large impact on estimates, and thus are the most important factors in determining the cost of a loan or group of loans or loan guarantees.
Liability for Loan Guarantees Account	the balance maintained in the general ledger that represents the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the outstanding loan guarantees.
Liquidating Account	the budget account that includes all cash flows to and from the Government resulting from <u>pre-1992</u> direct loans or loan guarantees, unless they have been modified and transferred to a financing account.
Negative Subsidy Receipt Account	the budget account for the receipt of amounts paid from the financing account when there is a negative subsidy cost for the original estimate or a downward reestimate. For mandatory programs, negative subsidies and downward reestimates may be credited directly to the program account as offsetting collections from non-Federal sources.
OMB Credit Subsidy Calculator	computer software developed by OMB for discounting cash flows in estimating credit subsidies. It uses agency cash flow inputs to compute the net present value at the point of disbursement and the subsidy rate associated with those cash flows.

Program in the context of Federal credit, an aggregation of cohorts which are linked by common terms, conditions, regulations, and/or mission goals; often a sub-division of a fund or the budgetary financing account.

Program Account the budget account into which an appropriation to cover the subsidy cost of a direct loan or loan guarantee program is made and from which such cost is disbursed to the financing account. Program accounts usually receive a separate appropriation for administrative expenses.

Risk category subdivisions of a cohort of direct loans or loan guarantees into groups of loans that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all loans obligated or committed for a program during the fiscal year that share characteristics predictive of defaults or other costs. All cohort level guidance in this technical release also applies to risk categories when they are used.

Service or line of business an aggregation of funds into a common grouping: for example, grouping funds into single family or multifamily designations. The following example is provided to illustrate the relationship the above terms have to each other and show how they may be aggregated for financial statement purposes. Agencies should consult applicable OMB guidance to determine what level of aggregation is most appropriate and acceptable.

Business line or service: Farm Service Agency

Fund:

- A.CCC Export Guarantees
- B.Agricultural Credit Insurance Fund

Program:

- B1.Farm Ownership Loans
- B2.Farm Operating Loans, subsidized
- B3.Farm Operating Loans, unsubsidized

Cohort:

- B3a.FY 1992 Farm Operating Loans, unsubsidized
- B3b.FY 1993 Farm Operating Loans, unsubsidized
- B3c.FY 1994 Farm Operating Loans, unsubsidized
- B3d.FY 1995 Farm Operating Loans, unsubsidized
- B3e.FY 1996 Farm Operating Loans, unsubsidized

Risk category:

- B3e1.FY 1996 Farm Operating Loans, unsubsidized,
Southwest Region
- B3e2.FY 1996 Farm Operating Loans, unsubsidized,
Northeast Region

Case:

- B3aiFiscal year 1992 unsubsidized loan to farmer
A
- B3aiiFiscal year 1992 unsubsidized loan to farmer
B

Appendix C: Summary of Reestimate Requirements

The table below summarizes the reestimate requirements for the budget and financial statement presentations.

	Budget	Financial Statement
Interest Rate Reestimate	<i>Frequency:</i> At least one time when the cohort is 90 percent disbursed - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	<i>Frequency:</i> Whenever the change in the interest rate materially affects the financial statements or, if no material change occurs prior to the cohort being 90 percent disbursed, at least one time when the cohort is 90 percent disbursed.
	<i>Timing:</i> At the end of the fiscal year.	<i>Timing:</i> Typically as of the end of the fiscal year.
Technical Reestimate	<i>Frequency:</i> Annually unless a different plan is approved by OMB - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.	<i>Frequency:</i> Any year when material. Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.
	<i>Timing:</i> At the end of the fiscal year unless otherwise approved by OMB.	<i>Timing:</i> Typically as of the end of the fiscal year. Also, agencies must disclose if the reestimate was calculated at a time other than the end of the fiscal year.

Appendix D: Summary of Selected Reporting Requirements¹⁵

Principal Statements	Credit Reform Information Presented
Balance Sheet	Credit program receivables and related foreclosed property, net of related subsidy allowance Liabilities for loan guarantees
Statement of Net Cost	Subsidy expense will be included as part of the gross program costs (present value of fees will be included as an offset in calculating subsidy expense rather than recording actual collection of fees as revenue) Interest revenue and interest expense
Statement of Changes in Net Position	Appropriations received (subsidy) and appropriations used
Statement of Budgetary Resources	Appropriations received (subsidy), borrowing authority, offsetting collections (examples: Collection of fees, principal, interest, subsidy from program account) and obligations (subsidy to financing account, direct loans, interest supplements, default claims) and offsetting receipts (example: negative subsidy or downward reestimate received by general fund receipt account)
Statement of Financing	Reconcile net obligations to net cost using components from the Statements of Budgetary Resources, Changes in Net Position and Net Cost. Examples of reconciling items include upward/downward reestimates of subsidy expense, offsetting collections pertaining to fees and obligations

¹⁵ Refer to FASAB Standards for a complete listing of accounting and reporting requirements. The requirements in the Standards may be supplemented by guidance provided in OMB Bulletin 01-09 and OMB Circular A-11.

Note Disclosures

Direct Loans (and Defaulted Guaranteed Loans) by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09. SFFAS No. 18 requires the reconciliation of the subsidy cost allowance for direct loans and not defaulted guaranteed loans.

Guaranteed Loans by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09.

Both Direct Loans (and Defaulted Guaranteed Loans) and Guaranteed Loans by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09.

Credit Reform Information Presented

By program or fund:

- Loans receivable gross,
- Interest receivable,
- Foreclosed property,
- Allowance for subsidy cost (present value), and
- Net value of assets related to direct loan programs (and loan guarantee programs)

Total amount of loans disbursed for current and prior years

Reconciliation between the beginning and ending balance of the subsidy cost allowance at the reporting entity level

By program or fund:

- Present value of post-1991 liabilities for loan guarantees
- Face value of guaranteed loans outstanding,
- Amount of outstanding principal guaranteed

Reconciliation between the beginning and ending balance of the loan guarantee liability at the reporting entity level

By program or fund:

- Total subsidy expense, and its components
- Total subsidy expense for modifications
- Total subsidy expense for reestimates, and their components, for current and prior year (interest and technical)
- Subsidy rates for the total subsidy cost, and its components, for the current year
- Total administrative expense
- Description of the characteristics of loan programs
- Discussion of 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 reestimates
- Nature of the modification of direct loans or loan guarantees, discount rate used to calculate the modification expense, and basis for recognizing a gain or loss relating to the modification.
- Restrictions on the use/disposal of foreclosed property, number of properties held and average holding period by type or category, number of properties for which foreclosure proceedings are in process and changes from prior year's accounting methods

Federal Financial Accounting And Auditing Technical Release 4: Reporting on Non-Valued Seized and Forfeited Property

Status

Issued	July 31, 1999
Effective Date	For fiscal periods beginning after September 30, 1999.
Volume II References	Seized and Forfeited Property (S30)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

Summary

An analysis of changes for all material non-valued seized property should be disclosed in the financial statement footnotes in the same manner as prescribed for non-valued forfeited property.

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Introduction

Guidance for the accounting and reporting of seized and forfeited property held by Federal entities is provided in the Statement of Federal Financial Accounting Standard No. 3, *Accounting for Inventory and Related Property* (SFFAS No. 3), issued in October 1993. This Technical Release is intended to clarify the required reporting of non-valued seized and forfeited property.

Agencies that must deal with non-valued seized and forfeited property should first refer to the hierarchy of accounting standards contained in the current Office of Management and Budget (OMB) Bulletin on “Form and Content of Agency Financial Statements” for guidance. Standards issued by Government Accountability Office (GAO) and OMB have precedence over other authoritative guidance for federal entities.¹ This technical release supplements the relevant federal standards, but is not a substitute for and does not take precedence over the standards.

This Technical Release includes a discussion of the issues and recommended implementation guidance that is intended to clarify the reporting of non-valued seized and forfeited property. This guidance also provides more detailed terminology relating to the measurement of these non-valued items (see Appendix A ... [See consolidated glossary in Appendix E of this document] for the list of terms).

Background

Federal entities implementing this standard have raised numerous questions requiring clarification of the reporting of non-valued seized and forfeited property. Numerous Federal entities’ missions include the task of seizing non-valued property. Bureaus within the Departments of the Treasury and Justice are most directly affected by this issue.

Non-valued property either does not have a legal market in the United States, or does not have a salable value to the Federal government. These items may be abandoned, embargoed, prohibited, sensitive, or seized for forfeiture. Examples of such items could include illegal drugs, counterfeit currencies and monetary instruments, and firearms, which the Federal government, as a matter of law or policy, does not return to the owner or

¹The Federal Accounting Standards Advisory Board recommends accounting concepts and standards to its principals; the Department of the Treasury, the Office of Management and Budget, and the General Accounting Office. If all three principals approve a recommendation it is issued by OMB and GAO.

sell upon forfeiture. Federal agencies that seize these types of items have had difficulty in applying the concept of materiality and in the reporting of these types of items since they do not have monetary value. Consequently, Federal agencies have independently determined what types of non-valued property should be disclosed in the financial statements under SFFAS No. 3 and the units of measure, resulting in inconsistent disclosures between agencies and disclosures that lacked meaningful information.

While non-valued seized property does not have a monetary value to the Federal government, the sensitive nature of much of this type of property requires the same level of accountability and security as valued property, if not more. Agencies should ensure that their systems of internal control are adequate to provide sufficient accountability and security over this property in order to meet the reporting requirements provided in SFFAS No. 3.

SFFAS No. 3 prescribes that seized property shall be accounted for in the financial records of the entity that is operating as the central fund (see SFFAS No. 3, para. 60). Central funds are established to finance the costs of the seizure, management, and disposition of property, and to receive the proceeds from the sale or disposition of that property. However, since non-valued items do not have a financial value, the central fund is not responsible for reporting these items.² Accordingly, the seizing or custodial entity is responsible for maintaining sufficient internal records to maintain control over these items and would have reporting responsibility for non-valued items.

Chapter 3 of the Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting* (SFFAC No. 1), identifies the users of Federal financial reports and their information needs. Federal financial report users need information to assess the accountability, stewardship, and operating performance of Federal agencies and programs. To address the information needs of Federal financial report users, Chapter 4 of SFFAC No. 1 defines the objectives of financial reporting as budgetary integrity, operating performance, stewardship, and systems and control. The discussion of these objectives emphasizes the concepts of the entity's control over, accountability of, and accomplishment of Federal programs and activities.

²This is generally because the central fund does not take custody of nonvalued items.

Furthermore, to provide additional useful perspective, SFFAS No. 3 includes a discussion on the concept of materiality. Specifically, the concept of materiality includes both quantitative and qualitative considerations. Thus, an item that is not considered material from a quantitative standpoint may be considered qualitatively material. Accordingly, items would be considered qualitatively material if the judgment of a person relying on the information presented about such items would be influenced by the omission or misstatement of information presented about those items. SFFAS No. 3 states that an item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user. It should be noted that SFFAS No. 3 also clearly states that items of a sensitive nature held by an entity that are not considered material to the entity's financial statements need not be reported.

Discussion of Issues

The disclosure requirements for seized and forfeited property are outlined in paragraphs 66 and 78 of SFFAS No. 3. Among the requirements is a footnote disclosure to contain: a description of the composition of the property; the methods of valuing the property; restrictions on the use of forfeited property; changes from prior year accounting methods, if any; and an analysis of changes in seized and forfeited property. The analysis of changes in seized and forfeited property should provide the dollar value and number of properties on hand at the beginning of the year, seizures and forfeitures made during the year, property disposed of and method of disposition, and property on hand at the end of the year. This information should be presented by type of property where material.

While SFFAS No. 3 provides adequate guidance for reporting seized and forfeited items with a financial value, the standard has not been interpreted and applied consistently with respect to non-valued items. Paragraph 148 of SFFAS No. 3 states that the standard was revised to address the disclosure requirements for non-valued items. For these items, the standard does not require the reporting of financial value, but it clearly requires the disclosure of all material forfeited property, including those items with no financial value. However, the standard does not address the disclosure of non-valued seized items. As a result, some reporting entities with seizing authority disclose non-valued seized items, and others do not. Clarification of the standard as it relates to non-valued seized items is needed to ensure consistent implementation.

With numerous professional disciplines involved in activities related to the seizure and reporting of non-valued items, some terminology has different meanings depending on whether it is used in a legal, accounting, or program management context. To provide for consistent and meaningful reporting, clarified definitions and standard units of measure are necessary.

Recommended
Implementation
Guidance

An analysis of changes for all material non-valued seized property should be disclosed in the financial statement footnotes in the same manner as prescribed for non-valued forfeited property.

The definitions in **Appendix A** ... [See consolidated glossary in Appendix E of this document] provide for consistent and meaningful reporting among Federal agencies that seize and/or forfeit non-valued items. The units of measurement for non-valued items provided in the **Attachment** are also designed to facilitate consistency in reporting among agencies. It is recognized that some agencies may be currently reporting in different measurement units and may be unable to convert their units of measurement for FY 1999 reporting. Such agencies may continue to report on their current basis for FY 1999 but should conform with the units of measurement provided in the Attachment for FY 2000 and subsequent years.

Attachment: **Measurement Of Non-valued Items**

Category	Standard Unit Of Measurement
Illegal Drugs	
Cannabis	Kilograms
Cocaine	Kilograms
Heroin	Kilograms
Methamphetamine/Amphetamine	Various
Other Categories ³	Various
Firearms and Explosives	
Legal Firearms	Number
Illegal Firearms	Number
Ammunition	Rounds
Explosives	Number
Counterfeit	
Currency - Completed (U.S. & Foreign)	Number of counterfeit bills
Credit Cards	Number
Other (e.g., other counterfeit monetary instruments)	Number

Note: This is not intended to be an all-inclusive list. Other categories should be considered as appropriate.

³Other categories include material amounts of other drugs seized, to be separately reported by liquid weight, dry weight, tablets, or other appropriate measurement.

**Appendix A:
Glossary**

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1371.

Federal Financial Accounting and Auditing Technical Release 5: Implementation Guidance on Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software

Status

Issued	May 14, 2001
Effective Date	for periods ending after September 30, 2001
Volume II References	Software (S50)
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

Summary

- I. This technical release is intended to provide guidance on implementing SFFAS 10.

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Introduction

1. The AAPC was asked to provide guidance to Federal entities on the implementation of Statement of Federal Financial Accounting Standards 10, *Accounting for Internal Use Software* (SFFAS 10). This Technical Release (TR) is intended to provide guidance on implementing SFFAS 10. This TR was prepared in conjunction with the Chief Financial Officers Council Task Force on the implementation of SFFAS 10; the AAPC agreed to publish in this TR certain issues raised by the task force.
2. Readers of this technical release should first refer to the American Institute of Certified Public Accountants' (AICPA) Auditing Standards Board hierarchy of accounting standards applicable to Federal entities¹. Standards issued by FASAB have precedence over other authoritative guidance for Federal entities. This technical release is considered a Level C. pronouncement in the hierarchy.
3. This guidance is based on the provisions of the following Federal standards
 - a. SFFAS 10, *Accounting for Internal Use Software*
 - b. SFFAS 5, *Accounting for Liabilities of the Federal Government*
 - c. SFFAS 6, *Accounting for Property, Plant, and Equipment*

Questions And Responses

Question 1

4. *Trigger Point for Capitalization and Amortization*² - How can management determine the point in time when it is more likely than not that a proposed software project will be implemented, and thus the capitalization and amortization periods start?

¹ AICPA Statement on Auditing Standards 91, *Federal GAAP Hierarchy*.

²SFFAS 10, paragraph 16a.

Response

5. SFFAS 10 states that “for internally developed software, capitalized costs should include the full cost (direct and indirect costs) incurred during the software development stage. Such costs should be limited to cost incurred after (a) management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function with an estimated service life of 2 years or more, and (b) the completion of conceptual formulation, design, and testing of possible software project alternatives (the preliminary design stage).”³ Each Federal agency should develop and document agency specific policies and procedures for this determination so that it is consistently implemented across new software developments.
6. In terms of amortization, SFFAS 10 states that “for each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of the module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing.”⁴ Generally, this point in time is before the Federal agency starts to realize the benefits of the new computer software system.

Question 2

7. *Capability vs. Functionality* - Certain costs extend the ability of a computer software system to perform tasks or make the application easier to use. Neither of these terms is defined in the Glossary, which may lead to a wide variety of interpretations. Are these terms synonymous within the context of SFFAS 10?

Response

8. The meaning of the term “capability” used in SFFAS 10 is very similar to the meaning of “functionality.” “Capability” is used in SFFAS 10 in the sense meaning an ability to perform an indicated use. “Functionality” is used in the sense meaning an ability to perform a specific function (an action for which a person or piece of equipment is specially fitted or used). SFFAS 10 states that an “enhancement”

³Ibid., Paragraph 16.

⁴Ibid., Paragraph 33.

occurs when, for example, a new “capability or function [is added] to existing software.”⁵ In applying the provisions of SFFAS 10, "capability" is synonymous with "functionality."

Question 3

9. *Useful Life of Software Based on Hardware* - To what extent should the useful life of software be based on the hardware on which it runs?

Response

10. In situations where software and the hardware on which it runs have independent service lives, the determination of the useful life of the software should be viewed independently of the useful life of the hardware. This determination should be made on a case by case basis for each Federal agency and is at the discretion of management of the agency. The rationale for this determination should be documented.
11. For integrated software, SFFAS 10, Paragraph 22, states the following.
- “Computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly (e.g., airport radar and computer-operated lathes). The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs.”

Question 4

12. *Capitalizing License Fees* - Full ownership of commercial software is rarely, if ever, transferred from the owner of the software to a Federal agency that desires to implement the functionality provided by that software. Rather, agencies acquire the right to use the software through the purchase of a license. When should software license fees be capitalized?

Response

13. Although SFFAS 10 did not address licensing within the body of the standard, the FASAB did state its belief in the Basis for Conclusions⁶

⁵ SFFAS 10, paragraph 25.

⁶ SFFAS 10, paragraphs 66-67.

that it would be appropriate for Federal entities to apply lease accounting concepts to licenses. The Committee therefore believes that when Federal agencies are making the determination as to whether software license fees should be capitalized, it would be appropriate for the agency to follow the lease accounting concepts as provided in SFFAS 5⁷ and SFFAS 6⁸, as well as appropriate policies for capitalization thresholds.

14. The Committee noted that the following Financial Accounting Standards Board (FASB) and AICPA standards provide guidance on accounting for software and licensing in general, and may be relevant to this topic.
- SFAS 50, *Financial Reporting in the Record and Music Industry*
 - SFAS 63, *Financial Reporting by Broadcasters*
 - SFAS 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*
 - SFAS 139, *Rescission of SFAS 53, Financial Reporting by Producers and Distributors of Motion Picture Films and Amendments to SFAS Nos. 63, 89, and 121*
 - FASB Highlights, *Computer Software: Guidance on Applying Statement 86*
 - AICPA SOP 97-2, *Software Revenue Recognition*
 - AICPA SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*
 - AICPA SOP 00-2, *Accounting by Producers or Distributors of Film*
 - EITF 00-2, *Accounting for Web Site Development Costs*
 - EITF 00-3, *Application of AICPA Statement of Position 97-02 (Software Revenue Recognition) to Arrangements that Include the Right to Use Software Stored on Another Entity's Hardware.*

Question 5

15. Capitalizable Costs vs. Executory Costs - How should a Federal agency capitalize a license agreement that may include executory costs (i.e., maintenance and technical support), as well as software

⁷ SFFAS 5, paragraphs 43-46.

⁸ SFFAS 6, paragraph 20.

upgrades? This may include upgrades that may either extend the useful life of the software or provide additional functionality.

Response

16. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts⁹ may be derived from the payment schedule contained in the license agreement. As stated in SFFAS 5, if the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.¹⁰ Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, e.g., initial license, maintenance, enhancement, etc.

Question 6

17. *Bulk Purchases* - Rather than buy individual packages of typical desktop software, many Federal agencies will acquire either a site or enterprise license, which allows unlimited use of a single package at a site or across the enterprise, or will buy, at a single time, a sufficient number of individual licenses to cover the use of a large percentage of the site or enterprise population (frequently referred to as a "seat license"). These acquisitions will in most cases exceed the capitalization threshold, but would not exceed the threshold if purchased separately. Should these types of purchases be capitalized?

Response

18. For these types of bulk purchases Federal entities should follow the guidance as stated in SFFAS 10, paragraph 24.
- “Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system. That guidance should consider whether period cost would be distorted or asset values understated by expensing the purchase of numerous copies of a

⁹ SFFAS 5, paragraph 44.

¹⁰ Ibid., paragraph 44.

software application or numerous components of a software system and, if so, provide that the collective cost should be capitalized.

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

Rescinding Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act*

Status

Issued	January 2004
Effective Date	Immediately
Volume II References	Loan and Loan Guarantees (L60)
Interpretations and Technical Releases	Technical Release No. 3 (Revised): Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>
Affects	Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act
Affected by	None.

Summary

This technical release amends the implementation guidance for agencies to prepare and report credit subsidy estimates provided in Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (TR3), July 1999. The original technical release (July 1999) contained both audit and accounting guidance. Technical Release 3 (revised) contains only the guidance for auditing estimates.

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Introduction

1. The purpose of this technical release is to amend the implementation guidance for agencies to prepare and report credit subsidy estimates provided in Technical Release 3: *Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act* (TR3), July 1999. The most significant changes made between the original TR3 and this amended TR are as follows:
 - a. Removal of the audit guidance from this amended TR to only include the preparation guidance.
 - b. Clarification of OMB's role in the credit subsidy estimation and re-estimation process. OMB has statutory authority over subsidy estimates in the Budget but has delegated the authority to calculate those estimates to the agencies. This document outlines guidance and tools provided by OMB for entities to use during their calculations of the credit subsidy estimates. The guidance also states that OMB provides economic assumptions to be used in the estimation and re-estimation of subsidies.
 - c. Credit subsidy reestimates may now include 6 months of actual data and 6 months of projected estimates. This would be a change from the current requirement of 9 months of actual data and 3 months of projected estimates.

The original Technical Release 3 (July 1999) contained audit guidance, as well as accounting guidance. Concurrent with the issuance of this technical release on accounting guidance, Technical Release 3 is being amended to contain only the audit guidance.

2. Readers of this technical release should first refer to the hierarchy of accounting standards in Statement on Auditing Standards (SAS) 91, Federal Generally Accepted Accounting Principles Hierarchy (or see AU411). This technical release supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This Technical Release is intended to facilitate consistency between the budgetary and financial statement presentation of subsidy estimates; however, fair presentation of subsidy estimates in the financial statements may be different from that in the President's Budget.
3. Federal agencies are required to account for direct loans and loan guarantees in accordance with Statement of Federal Financial Accounting Standards No. 2, *Accounting for Direct Loans and Loan*

Guarantees (SFFAS No. 2), SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, and SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees*. In developing the financial accounting standards in SFFAS No. 2, the Board recognized "the value of having financial accounting support the budget" and recommended that "accounting standards for credit be consistent with budgeting under credit reform." Further, the Board stated that "as more experience is gained, some modifications may be made in budgetary requirements. It is the intention of the Board that so long as the modifications are made on a credit reform basis and do not materially affect the basic recognition and measurement principles embodied in the accounting standards, accounting practices for direct loans and loan guarantees should change as needed in order to be consistent with the budget."¹ This technical release provides guidance on acceptable accounting practice in light of current budgetary requirements.

4. This technical release includes sections on:
 - OMB's role in the Subsidy estimation and re-estimation process and
 - Preparing Direct Loan and Loan Guarantee Subsidy Estimates

5. It also presents two appendices on:
 - Technical Glossary and
 - Summary of Selected Reporting Requirements

6. This technical release does not address loan asset sales and does not provide complete guidance for administrative expenses and pre-1992 direct loans and loan guarantees. Guidance on these areas can be found in SFFAS Nos. 2, 18, & 19 and OMB Circular No. A -11 and OMB Bulletin No. 01-09. Additional guidance on loan asset sales will be addressed separately in the future.

¹ SFFAS No. 2, paragraph 17. Also see SFFAS No. 2 paragraph 66.

Background

7. Since the Credit Reform Act of 1990 was passed, agencies have struggled with the numerous challenges in implementing the various provisions of the act—especially formulating credit subsidy estimates. This technical release is designed to provide guidance on the preparation of credit subsidy estimates. There are three parts of subsidy: initial subsidy, modifications of subsidy and reestimates of subsidy. A goal of this technical release is to provide implementation guidance that will ensure greater financial statement consistency with the accounting standards set forth in Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, SFFAS No. 18, *Amendments to Accounting for Direct Loans and Loan Guarantees*, and SFFAS No. 19, *Technical Amendments to Accounting for Direct Loans and Loan Guarantees*.²
8. The technical release begins with a discussion of the OMB's role in the credit subsidy estimation and re-estimation process. It continues by addressing procedures for preparing estimates and reestimates—including acceptable interim alternatives in the absence of the ideal data store and estimation methods. This technical release also provides guidance on acceptable sources of documentation for subsidy estimates and reestimates.

Materiality

9. The provisions of this guidance need not be applied to immaterial items.

Effective Date

10. The guidance outlined in this technical release is effective immediately.

OMB Role

11. Under the Federal Credit Reform Act of 1990, as amended, OMB is responsible for subsidy estimates published in the President's Budget. OMB has delegated the authority to the agencies to calculate estimates but retains the responsibility and final approval of subsidy estimates, reestimates, and modification cost estimates. For agencies that have

² Authoritative guidance for the recognition of many transactions under credit reform is also included in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, Appendix B, "Guidance for the Classification of Transactions," paragraphs 362-365 and 368 - 369.

credit programs, OMB provides guidance and specific tools for credit budgeting.

12. OMB Circulars A-11 Preparation, Submission, and Execution of the Budget and A-129 Policies For Federal Credit Programs and Non-Tax Receivables provide guidance to agencies on definitions, procedures and rules for calculating subsidy estimates and reestimates for the President's Budget and modification cost estimates, obligation of budget authority for the credit program's cost, and credit and receivables policy.
13. The Credit Subsidy Calculator (CSC) is a computer program provided to the agencies to calculate the cost of direct loans and loan guarantees using the agencies' cash flow estimates. The OMB Circular A-11 requires that all agencies with credit programs must use the CSC to discount the credit subsidy estimate and reestimate cash flows that they are responsible for generating.
14. OMB provides spreadsheets and instructions to calculate reestimates and interest paid and received for financing accounts.³
15. Each year, in preparing the President's Budget, OMB provides agencies with a set of economic assumptions that must be used when determining budget estimates. Some of these assumptions, such as gross domestic product (GDP), are used for both credit programs and others. For credit programs specifically, the economic assumptions include the discount rates, which are derived from the Treasury yield curve, used to calculate subsidy estimates. The discount rates are built into the most recent version of the CSC. Prior year actual discount rates and credit related assumptions are available from OMB ten business days prior to the close of the fiscal year.

³ The CSC and spreadsheets for calculating reestimates and financing account interest are available on the Federal Credit Support Page (<http://www.omb.gov/credit>).

Preparing Direct Loan and Loan Guarantee Estimates

16. Preparing reliable and timely direct loan and loan guarantee subsidy estimates must be a joint effort between the budget, CFO and program offices at each agency. These offices should work together to ensure that the procedures and internal control⁴ outlined in this section are implemented and operating as designed. However, some agencies may not be able to effectively implement all of these procedures, since they have not yet developed the ideal data stores or methods of estimation necessary. Therefore, until the required information on all cash disbursements and collections related to direct or guaranteed loans can be collected at the case level and summarized, by cohort and program, the acceptable alternatives identified in this technical release will need to be utilized to provide the necessary information for developing subsidy estimates.
17. Agencies must accumulate sufficient relevant and reliable data on which to base cash flow projections. It is important to note that agencies should prepare all estimates and reestimates based upon the best available data at the time the estimates are made. Agencies should prepare and report reestimates of the credit subsidies, in accordance with SFFAS No. 2, 18, and 19, to reflect the most recent data available as discussed in the reestimate section of this technical release. The OMB Circular A-11 also provides guidance on reestimating credit subsidies. Guidance on the types of supporting documentation that is acceptable is found in paragraphs 20 - 22 of this technical release.
18. In certain limited instances, informed opinion may be used to support cash flow projections in the absence of historical data. Informed opinion refers to the judgment of agency staff or others who make subsidy estimates based on their programmatic knowledge and/or experience without using a fully satisfactory information store and, in some cases, without using an econometric or other statistical model. Informed opinion may be used only as a last resort when relevant historical data and/or modeling capabilities are not available. This could occur when a new program has been established or when the

⁴ Internal control is an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, risk assessment, control activities, information and communication and monitoring.

Congress has changed an existing program in ways that cannot be represented by historical data. Informed opinion should therefore be used as an interim method only, and the agency should develop an action plan to establish an information store, appropriate models, and supporting documentation.

19. Certain conditions must be met before informed opinion will be considered an appropriate source of information. First, the expert's qualifications, such as professional or academic certification or length and kind of experience, must be assessed. Then, the basis of the stated opinion must be articulated and documented in detail. For example, a statistician may be best qualified to determine the appropriate kind of model for estimated cash flows using limited or imperfect data. Most importantly, the expert must document why that particular projection is appropriate for that particular program.
20. Documentation must be provided to support the assumptions used by the agency in the subsidy calculations. This documentation will not only facilitate the agency's review of the assumptions, a key internal control, it will also facilitate the auditor's review. Documentation should be complete and stand on its own, i.e., a knowledgeable independent person could perform the same steps and replicate the same results with little or no outside explanation or assistance. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purposes of reconstructing the estimate.
21. Management should ensure that the following documentation is available for initial subsidy estimates, reestimates, and modifications of existing credit programs:
 1. Procedures for calculating the subsidy estimate,
 2. Review and approval process of the subsidy estimate, including the sign-off procedure within the agency,
 3. Calculation of the recorded subsidy estimates, including the underlying assumptions and cash flow model,
 4. Historical supporting documents used in the underlying assumptions,
 5. Documentation of relevant supporting actual cash and economic experience (including the date and source of reports, and how recently the data were updated), which may include:
 - Cash reports on historical performance,

- Historical data and trends, citing sources of information and relevant time frame,
 - Sensitivity analysis or other analysis that identifies the most critical factors,
 - Reports from the accounting or management systems showing trends
 - Actuarial studies,
 - Experience of other agencies with similar programs,
 - Emergencies (acts of God) or legislated changes (acts of Congress), such as changes in the program terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population, and
 - Economic and/or industry data and subsequent analyses, including industry studies, journal articles, trade papers, and third party studies.⁵
6. Documentation of relevant program design factors, which may include:
- Program definition including fees, grace period, term to maturity, borrower interest rates, legal definitions, and enabling or enacted legislation,
 - Legislation or regulations changing the terms, maximum allowable loan amount, total program size, or characteristics of the credit program's borrower population,
 - Program eligibility requirements,
 - Lender agreements detailing the terms of the guarantee, and
 - Borrower contracts outlining the terms and conditions of the loan or guarantee.
22. Management should ensure that the following documentation is available for new programs or changes to existing programs that may not have historical supporting documentation for cash flow assumptions and spreadsheets. In the absence of valid and relevant historical experience as the support for cash flow assumptions, the agency should document the basis for cash flow assumptions. Typical support will include:

⁵ For example, past data may document the historical relationship between interest rates, whereas an independent study may demonstrate how trends in past data are expected to change in the future.

- Relevant experiences from other agencies, including documentation of why another agency's experience is relevant, as well as similarities and differences (particularly possible biases) between the other agency's experience and the changes to existing programs or new programs,
- Extrapolation from subsets of prior program activity, e.g., while prior loans were not targeted for single heads of households, it may be possible to identify prior loans that were made to single heads of households and the experience of such loans in prior records.
- Assumptions used by underwriters for the purposes of determining eligibility, loan approval, or credit scoring.
- Private sector proxies for risk, such as bond ratings to assess default risk, may be used when there is no relevant Federal Government experience. For example, an agency may consider using bond ratings for a state agency that finances similar loan programs, such as education, farm, or housing, with bonds.
- Extrapolations from private sector lending experience including documentation explaining why this experience is applicable to the agency's credit program and possible biases for which an adjustment is needed, e.g., different borrower characteristics.
- Expert opinion may also be used as an interim measure to support cash flow assumptions. In these cases, the agency must document the expert's qualifications, such as professional or academic certification or length of experience, as well as the basis of the stated opinion. In addition, the following documents should be maintained in support of the expert's opinion:
 - Memos from conversations with outside experts,
 - Reports and studies on similar industry conditions,
 - Minutes from internal meetings describing the basis for any assumptions or changes in assumptions, and
 - Previous studies conducted by the expert, including industry studies, journal articles, and third party studies.

Overall CFO/Budget
Procedures and Internal
Control

23. Document the procedures and flow of information used in developing the agency's subsidy estimates at a high level, e.g., flow chart with supporting narrative. These documents should be used to establish consistent procedures for developing the subsidy estimates across funds/programs/cohorts. These documents should also include a discussion of who is responsible for each step of the estimate as well as the review and approval process followed. Documented procedures are necessary to communicate information on the subsidy estimation and re-estimation process to employees as well as other interested parties, such as auditors and OMB examiners. Also, when employee turnover is experienced, these documented procedures will provide vital information for new employees on how to complete reliable, well supported estimates of the costs of credit programs.
24. Document the agency's cash flow model(s) used, the rationale for selecting the specific methodologies, and the degree of calibration⁶ within the model(s). Also, document the sources of information, the logic flow, and the mechanics of the model(s) including the formulas and other mathematical functions. In addition, document the controls over the model(s) used by the agency in preparing cash flow worksheets. Further, document that the cash flow model(s) reflect the terms of the loan contracts and, in a loan guarantee program, the loan guarantee contracts. Additional details regarding internal control are discussed in the specific fund/program procedures and controls section of the technical release.
25. For agencies that have not yet implemented the ideal data store or implemented the estimation methods described in the Model Credit Program Methods and Documentation for Estimating Subsidy Rates and The Model Information Store (issue paper 96-CR-7), available from the AAPC web page (<http://fasab.gov/aapc/cdreform/othercrddoc.htm>), document management's strategic plans towards improving the agency's information store and estimation methods. This strategic plan should include who is responsible for various aspects of the plan and

⁶ Calibration is the degree of precision within the model, i.e., the model's ability to accurately predict the cash flows of a given credit program. The degree of calibration within the model can be documented by charts or graphs showing projected cash flows versus the actual cash flows by year and cohort. This document would analyze the variance between projected cash flows and actual cash flows over time.

milestone dates for significant plan segments. Finally, it should document the progress at achieving the plan goals.

26. Ensure that general data and assumptions applicable to more than one cohort are used consistently for current year estimates and reestimates. For example, the overall economic conditions should be consistent for all cohorts within a program for a given fiscal year or management should document the reasons for the deviations, e.g., different economic assumptions could appropriately vary for specific geographic regions.
27. Ensure that estimates and all key assumptions used in preparing the budget and financial statements have been coordinated with both the program and accounting offices.
28. Management should assess the impact of changes in laws or regulations on the reliability of estimates and should ensure that the cash flow model reflects these changes. For example, a legislative program change may include provisions about maturity or type of borrowers that are outside the scope of past agency experience or may include program changes that shift the composition of new lending toward more or less risky borrowers.
29. The budget and accounting offices should work together to ensure that cash flow models are updated to reflect the actual cash flows and terms of the loan program recorded in the accounting records. Where material differences exist between the initial budgetary estimate and the actual cash flows, the differences should be investigated and reestimates and/or adjustments to the model should be made as required.⁷ Actual obligations, disbursements, recoveries, and receipts should be recorded on a case-by-case basis. The detail of these transactions should be reflected in the accounting records. However, when this level of detailed information is not available, it may be necessary for the agency to record transactions on another basis. For example, agencies may only receive information in summary from entities that actually make the loans that the Government guarantees.

⁷ Reestimates may not be required in all cases where material differences exist between the initial budgetary estimate and the actual cash flows. For example, if offsetting differences exist in cash flows, such as positive difference in default recoveries and a negative difference in fees, a reestimate may not be necessary.

As a result, the agency may need to estimate cash flows based on a detailed analysis of the loan portfolio as a whole and allocate program level cash receipts and disbursements to individual cohorts on an appropriate basis. The basis for this allocation should be clearly documented. Transactions may also be recorded based on estimates derived from representative samples of loans, and/or related transactions, e.g., sampling of loan receipts to allocate cash receipts to cohorts.

30. Interest expense and income should be calculated in accordance with guidance from OMB. Discount rates used should be based on the authorized rates from OMB.
31. The agency should have an audit trail from individual transactions to the subsidiary ledgers to the general ledger. This will ensure that cash transactions can be identified by type so that they may be identified by subsidy expense component. SFFAS No. 18 states: "Reporting entities... should disclose for each program ...the subsidy expense by components as defined in paragraphs 25 through 29 [SFFAS No. 2], recognized for the direct or guaranteed loans disbursed in those years [current reporting year and the preceding reporting year]..."
32. When a direct loan or loan guarantee is modified as defined by SFFAS No. 2 (additional guidance provided in the OMB Circular A-11), the nature of the modification, the estimated effect on cash flows, and key assumptions should be documented in the same way as the original subsidy estimate. Modifications do not include routine administrative workouts of troubled individual loans or actions that are permitted within the existing contract terms.⁸
33. Ensure that the financial statements consolidate the activity of the program accounts, the financing accounts, and, if needed, the negative

⁸ Neither the Federal Credit Reform Act as enacted in 1990 nor its amendments in the Balanced Budget Act of 1997 explicitly states that modifications do not include routine administrative workouts. However, the definition of modification in the 1990 Act was interpreted as excluding routine administrative workouts, and the definition in the 1997 amendments is interpreted in the same way. This interpretation is consistent with paragraph 44 of SFFAS No. 2. Further, the Joint Explanatory Statement of the Committee of Conference on H.R. 2015, the Balanced Budget Act of 1997, states that "workouts are not assumed to be included in the definition of modifications. The conference agreement does not change the treatment of workouts as implemented under the Federal Credit Reform Act of 1990."

subsidy receipt accounts. Negative subsidy receipt accounts are established for programs that have negative subsidies or downward subsidy reestimates (except certain programs classified in the budget as mandatory).

34. Cash flow spreadsheets should be prepared on a cohort or disbursement year basis, as appropriate. Cash flow spreadsheets prepared on a cohort basis include one line for each cash flow type (for example, principal payments, fees, or defaults). Cash flow spreadsheets prepared on a disbursement year basis include one line per disbursement year for each cash flow type (for example, principal payments associated with first year disbursements, principal payments associated with second year disbursements, etc.). The documentation for the Credit Subsidy Calculator provides details on how to indicate that a particular cash flow line is associated with a particular disbursement. When loan disbursements occur over multiple years, cash flow spreadsheets prepared on a disbursement year basis will produce a more precise subsidy calculation. However, when agencies are unable to provide this level of detail, combinations of multiple disbursement years may be used as an approximation.
35. Establish security over access to the OMB Credit Subsidy Calculator to adequately protect it from unauthorized use and corruption. For example, agency management should establish procedures to ensure that the desktop workstations where the OMB Credit Subsidy Calculator resides are password protected. In addition, the data used as input or generated as output should also be safeguarded and reviewed for errors.

**Specific Fund/Program
Procedures and Controls**

36. Procedures in place should ensure that cash flow estimates for budgetary and financial statement reporting purposes are based on actual cash flows in previous years to the extent it is appropriate. Agencies should compare budgeted to actual cash flows to ensure that the cash flow models reflect the actual cash flows from the accounting records. Where material differences exist between the initial budgetary estimate and the actual cash flows, the differences should be investigated and reestimates and/or adjustments should be made as required.⁹ Changes in key factors and assumptions used as a baseline (e.g., disbursement rates, default rates, recovery rates, time periods, etc.) must be explained, supported, and documented. For example, recoveries have averaged a given percentage for the past four years

and this recovery rate had been consistently used in preparing cash flow worksheets. However, during the past year, events have occurred which have increased the recovery rate and these events are expected to continue in the future. As a result, the agency may decide to use a recovery rate above the historical average.

37. Sensitivity analysis (or other testing of the agency cash flow models used in developing the subsidy estimates) should be performed to identify which cash flow assumptions have the greatest impact on the credit subsidy rate. To perform sensitivity analysis, management must first identify the root of each cash flow assumption¹⁰ to ensure that all subsequently related formulas and assumptions are adjusted appropriately. Generally, each root assumption should be individually adjusted by a fixed proportion (e.g., plus and minus 10 percent), and the revised cash flows run through the OMB Credit Subsidy Calculator to determine the assumption's effect on the subsidy rate. Timing assumptions for defaults, recoveries, prepayments, etc. should also be adjusted by a fixed amount (e.g., plus and minus one year). The recovery assumption should be adjusted along with the timing of recovery assumption to ensure that a realistic relationship between these two assumptions continues to exist, i.e., to test the sensitivity of recoveries, the default timing assumption must also be adjusted to ensure that the recovery occurs after the default. Those assumptions that caused the largest change in the subsidy rate are determined to be the key cash flow assumptions.
38. Key assumptions, identified by the sensitivity analyses that are utilized in the process of developing estimates, should be documented including the rationale, justification, and source of supporting documentation.
39. The accounting office should maintain detailed subsidiary accounting records by program, cohort, risk category (if applicable) and case (individual direct loan or loan guarantee).

⁹ Reestimates may not be required in all cases where material differences exist between the initial budgetary estimate and the actual cash flows. For example, if offsetting differences exist in cash flows such as a positive difference in default recoveries and a negative difference in fees, a reestimate may not be necessary.

¹⁰ The root of the cash flow assumption is the starting point for the assumption, i.e., there are no preceding formulas or related inputs that would affect the assumption.

40. The cash flow estimation process, including all underlying assumptions, should be reviewed and approved at the appropriate level including revisions and updates to the original model. Cash flow models should be tested for reliability as part of the approval process by comparing estimated cash flows to actual cash flows and assessing the model's ability to replicate a credit program's performance.
41. The agency should do trend analysis of the credit subsidy expense components, i.e., interest, defaults, fees, and other. When unusual fluctuations are identified, they should be investigated and explained.
42. The agency must document the options used in the OMB Credit Subsidy Calculator and the reasons those options were selected.¹¹
43. The agency should determine whether the proper dollar scale (e.g., whole dollars, hundreds, thousands, etc.) for the cash flow spreadsheets was used. Some program subsidy rates, particularly those for programs disbursing over several years, may be influenced slightly with the scale of the program. Therefore, management should determine whether rounding to three decimal places has no significant effect on the cash flow spreadsheet values and the subsidy rate.
44. The agency should determine whether the OMB Credit Subsidy Calculator options selected properly reflect specific characteristics of the applicable credit program. For example, the OMB Credit Subsidy Calculator option for the timing of principal and interest payments for direct loan program and the timing of commitments and disbursements by the private lender of a loan guaranteed should agree with the program's credit terms.
45. The agency should review the OMB Credit Subsidy Calculator output to determine whether any warning messages are listed and determine why the situation causing the warning message was not resolved and whether not eliminating the error could have any impact on the subsidy rate calculation. Also, if applicable, the agency should determine whether the suppression of any error messages was appropriate by checking the agency's cash flow spreadsheet to

¹¹ OMB contracted with an independent public accounting firm to review the OMB Credit Subsidy Calculator's compliance with the Credit Reform Act. Results of the audit may be obtained from the applicable OMB program examiner or OMB's Budget Analysis Branch.

determine whether the "suppress warnings" command was used and assess the impact these suppressed error messages could have on the cash flows.

46. The agency should review trends in the direct loan subsidy allowance account balance and/or the liability for loan guarantees account balance as compared to the outstanding balances of loans and/or guarantees. Any unusual fluctuations identified should be investigated and explained. When unusual fluctuations occur, an analysis by cohort may be helpful to identify the causes.

Reestimates

47. OMB Circular A-11 has established criteria for when agencies should calculate credit subsidy reestimates for the budget. It states that "interest rate reestimates of the subsidy cost of a cohort of direct loans or loan guarantees must be made when a cohort has substantially disbursed (i.e., when at least 90 percent of the direct loans or guaranteed loans have been disbursed.) The computation should be made after the close of the fiscal year in which this criterion is met, unless a later time within the same fiscal year is approved by the OMB representative with primary budget responsibility for the credit account"; and that "technical reestimates of the subsidy cost of a cohort of direct loans or loan guarantees must be made after the close of each fiscal year as long as the loans are outstanding, unless a different plan is approved by the OMB representative with primary budget responsibility for the credit account. The different plan might be with regard to the time when reestimates are made within the year or the frequency of reestimates." If the plan allows technical reestimates to be made less frequently than every year, it should require technical reestimates to be made for any year when any one of four conditions is met.¹² The period for which reestimates are to be calculated includes the first year that loans were disbursed. Reestimates are calculated as of the end of the fiscal year regardless of when the actual computation is performed.

¹² These four conditions are: (1) based on periodic schedules established in coordination with OMB, (2) when a major change in actual versus projected activity is detected, (3) when a material difference is detected through monitoring "triggers" developed in coordination with OMB, and (4) when a cohort is being closed out.

48. SFFAS No. 2 states that "the subsidy cost allowance for direct loans and the liability for loan guarantees are reestimated each year as of the date of the financial statements. Since the allowance or the liability represents the present value of the net cash outflows of the underlying direct loans or loan guarantees, the re-estimation takes into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies and recoveries.¹³ Any increase or decrease in the subsidy cost allowance or the loan guarantee liability resulting from the reestimates is recognized as a subsidy expense (or a reduction in subsidy expense) as of the end of the fiscal year to which it applies. Reporting the subsidy cost allowance of direct loans (or the liability of loan guarantees) and reestimates by component is not required." SFFAS No. 7, paragraphs 362-363, states that "[a] negative subsidy..." or "...downward subsidy reestimate is recognized as a direct reduction in expense, not as a revenue, gain, or other financing source." In addition, SFFAS No. 18 requires that the interest rate and technical reestimates be disclosed separately for each program.
49. The table below summarizes the reestimate requirements for the budget and financial statement presentations.

¹³ OMB has an alternative method of computing reestimates, the "balances approach," which compares (a) the net present value of the best current estimate of the remaining cash flows with (b) the net balance owed to Treasury (for direct loan programs) or the net balance on deposit with Treasury (for loan guarantee programs). In estimating the net present value of the remaining cash flows, agencies would still need to estimate future cash flows based on actual experience with cash flows to date and forecasts of other factors. They would therefore still need to maintain historical cash flow data, at the subsidy component level, to analyze the sources of error in the estimates of cash flows for past periods.

	Budget	Financial Statement
Interest Rate Reestimate	<p><u>Frequency:</u></p> <p>At least one time when the cohort is 90 percent disbursed - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.</p>	<p><u>Frequency:</u></p> <p>Whenever the change in the interest rate materially affects the financial statements or, if no material change occurs prior to the cohort being 90 percent disbursed, at least one time when the cohort is 90 percent disbursed.</p>
	<p><u>Timing:</u></p> <p>At the end of the fiscal year.</p>	<p><u>Timing:</u></p> <p>Typically as of the end of the fiscal year.</p>
Technical Reestimate	<p><u>Frequency:</u></p> <p>Annually unless a different plan is approved by OMB - regardless of financial statement materiality. In addition, reestimates should be recorded in the Budget whenever made for financial statement purposes.</p>	<p><u>Frequency:</u></p> <p>Any year when material.</p> <p>Also, agencies must disclose significant subsequent events after the reestimate date in the financial statement footnotes.</p>
	<p><u>Timing:</u></p> <p>At the end of the fiscal year unless otherwise approved by OMB.</p>	<p><u>Timing:</u></p> <p>Typically as of the end of the fiscal year.</p> <p>Also, agencies must disclose if the reestimate was calculated at a time other than the end of the fiscal year.</p>

50. An interest rate reestimate of the subsidy cost of a cohort of direct loans or loan guarantees is made for the difference between (a) the interest rate assumed in the President's budget for the fiscal year in which the subsidy is obligated, and (b) the actual annual interest rates prevailing during the years of disbursement. OMB Circular A-11 instructs that an interest rate reestimate should be made when the cohort is 90 percent disbursed.¹⁴ However, when an interest rate

¹⁴ If the interest rate assumption is a key assumption, agencies should consider using sensitivity analysis, as discussed in the section entitled *Specific Fund/Program Procedures and Controls*, to determine whether the change in interest would have a material affect on the financial statements. To do this, agencies would need to repeatedly adjust the interest rate by predetermined increments, e.g., plus or minus 100 basis points, and re-run the revised cash flows through the OMB Credit Subsidy Calculator to determine the impact on the subsidy rate. Agencies should then multiply the revised subsidy rate by the assumed disbursement amount, to calculate financial statement impact. As a result, agencies will be able to document the amount of interest rate change that would be necessary, under an assumed disbursement amount, to materially affect the financial statements.

change has occurred that would materially affect the financial statements, agencies should calculate the interest rate reestimate and include the reestimate in the current year's financial statements.

51. A technical reestimate of the subsidy cost of a cohort of direct loans or loan guarantees is made for all changes in assumptions other than discount rates. If OMB has approved a plan that permits an agency to make technical reestimates less often than annually, the agency should monitor the indicators specified in that plan to determine whether a reestimate is needed for other reasons: in particular, because it is needed to comply with other parts of that plan and/or because the reestimate has a material financial statement impact.
52. An agency that does not plan to perform technical reestimates annually must establish a systematic process to determine each year whether a reestimate is necessary and, if material to the financial statements as a whole, the reestimate must be reflected in the current year's financial statements. If an acceptable monitoring process is not in place, reestimates must be made annually for the financial statements. An acceptable process would generally include the following:
 - a. *A comparison between actual experience to date and the assumptions that had been previously used for the period to date.* – An acceptable process would regularly (but not less than annually) compare the actual cash flows, by subsidy component, reported by the accounting office at the program level to those used in the previous budget estimates.
 - b. *Differences between the current best estimate of future cash flows and the assumptions that had been previously used.* – An acceptable process would also include procedures that identify and systematically monitor significant economic and other assumptions underlying cash flows in order to determine whether changes have occurred in the expected future cash flows that make a reestimate necessary. The significant assumptions would be expected to differ from program to program according to each program's own attributes. Economic changes could include, for example, recessions, changes in interest rates, and changes in the market value of collateral or international economic factors (such as trade disruptions). Other changes could include, for example, legislative or administrative program changes (of the kind that do not meet the OMB Circular A-11 definition of a

modification), operational changes (such as reduction in staff because of budgetary constraints that would affect loan servicing), environmental changes, or war. The impact of these changes on the estimates of future cash flows (and, if necessary, the cash flow models) must be assessed and documented.

- c. *Special emphasis for programs that have peak periods* - Where applicable, an acceptable monitoring process should provide extra emphasis during periods when cohorts are experiencing significant increases or decreases in defaults, prepayments, recoveries, or other cash flows. For example, suppose for one particular program historical experience has demonstrated that a cohort usually experiences increased defaults starting in year three which peak in years 6 through 8. Historical experience has further demonstrated that defaults decline steadily beginning in year nine, until a stabilized rate is reached in years 13 through 30. During years 3 through 13, the agency's monitoring efforts should compare actual cash flows for defaults reported by the accounting department to estimated default cash flows as a way of validating the default cash flow assumption and determining whether a reestimate or adjustment to the overall rate or timing is necessary. However, once the monitoring system has demonstrated that the cohort has stabilized and no significant unusual events have occurred, it is less likely that annual reestimates would be necessary.

53. In years for which reestimates are made, they should normally be made as of September 30 of the reporting period using a data base that is complete through the same date. If OMB has approved a plan to make reestimates at another time during the year, this will be acceptable for financial statement purposes if the following conditions are met:

- a. The technical reestimate of the subsidy cost is made for a 12-month period ending not earlier than March 31, using actual transaction data through March 31 of the reporting year. Agencies may also use actual transaction data beyond the March 31 date through to the end of the reporting period. The reestimated subsidy cost is compared with the previous estimate of the subsidy cost for the year ended September 30.¹⁵ The

¹⁵ See footnote 12 for a discussion of the "balances approach" for calculating reestimates.

- difference is the amount of the reestimate. Alternatively, for the last two quarters of the fiscal year (or for a portion of this period), agencies may estimate those quarters' cash flows on a reasonable basis e.g., the last two quarters' cash flows from the previous fiscal year, or if the cash flows are relatively uniform, two quarters of the originally estimated cash flows, or the average cash flows of the previous two quarters. For cohorts with an interest rate reestimate, the interest rate reestimate and a revised technical reestimate¹⁶ would be calculated after September 30 using actual interest rates.
- b. In order to use this approach, agencies must ensure that the monitoring process described previously includes monitoring major events occurring during the third and fourth quarters that could have a significant impact on the subsidy reestimate. If such an event is identified, an adjustment to the reestimate of the affected cohorts may be necessary.
 - c. Agencies may be unable to calculate, and reflect in the financial statements, a reestimate for major events occurring during the third and fourth quarters because, at this point, the effects of the major event may not yet be determinable. In this case, agencies must disclose such events in the footnotes as a potential material uncertainty. The disclosure will further acknowledge that this/these event(s) will be taken into consideration in making the reestimate for the following year or once the impact of the events is determinable.
 - d. This policy, when adopted by an agency, with OMB's approval, will be disclosed in the footnotes to the agency's financial statements.
54. If OMB has approved a plan to make reestimates at another time during the year that does not meet the conditions detailed in paragraph 47 above, its financial statement impact should be evaluated. The conditions listed in paragraph 47 are just one acceptable scenario that details the steps that agencies should perform to ensure that the financial statements are materially correct. Agencies may develop alternative procedures to ensure financial statements are fairly presented without performing a full reestimate as of the date of the financial statements. The agency and OMB examiner

¹⁶ A revised technical reestimate in this context is limited to the change in the reestimate due to revised discount rates and not to any difference in cash flows.

may wish to collaborate in developing the alternative procedures that will best address each individual agency's workload, the needs of the budget, financial statements, and all applicable standards.

55. If the most recent estimated cash flows of a cohort are different from the actual experience, these differences and the reasons for these differences may affect the future estimated cash flows of that cohort. The effects on the future cash flows of that cohort need to be assessed and included in the reestimate, and the reasons for the estimated effects need to be documented.
56. Reestimates for any of the reasons in this section should be completed, submitted to OMB, and included in the current year's financial statements, on a timely basis.¹⁷ If OMB has approved a plan that permits an agency to make technical reestimates less often than annually, written documentation of the plan and OMB's approval should be obtained. If a technical reestimate is not made in a particular year, documentation should explain why that is consistent with the approved plan and provide assurance (in the ways specified above) that the lack of a technical reestimate would not have a material financial statement impact.¹⁸
57. Reestimates submitted by the budget office to OMB should be recorded in the accounting records. The agency should have an audit trail from individual transactions to the subsidiary ledgers to the general ledger. This will ensure that cash transactions can be identified by type so that they may be identified by subsidy expense component. SFFAS No. 18 states: "Reporting entities... should disclose for each program ...the subsidy reestimates by components as defined in paragraph 32 [SFFAS No. 2] for those years [current reporting year and the preceding reporting year]."

¹⁷ Fair presentation of subsidy estimates in the financial statements may differ from estimates in the budget.

¹⁸ OMB has established a four-step process, outlined in OMB Circular A-11, that allows for calculating budgetary technical reestimates for the budget at times other than the beginning of each fiscal year following the year in which the initial disbursement was made, as long as the loans are outstanding (subject to OMB approval). However, this does not allow agencies to omit material reestimates from the current year financial statements or to postpone including material technical reestimates in the financial statements until a subsequent year. Conversely, the OMB process may require agencies to make technical reestimates for the budget that are not material to the financial statements.

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58. If the cause of the reestimate affects the cash flows of future cohorts, the assumptions used to produce cash flow estimates and/or the method of estimating cash flows should be revised appropriately for the budget estimates of future cohorts.

Appendix A: Technical Glossary

Allowance for Subsidy *See Direct Loan Subsidy Allowance Account definition.*

Assumptions basic beliefs about the future operating and functional characteristics of the loan or group of loans or loan guarantees. Types of assumptions include:

Cash flow assumptions - all known and/or forecasted information about the characteristics and performance of a loan or group of loans or loan guarantees. Examples include estimates of loan maturity, borrower interest rate, default/delinquency rate, timing of defaults, overall impact of changes in economic factors, etc.

Model assumptions - determinations of how cash flow assumptions are applied through the life of the cohort. For example, determining whether the entire assumed amount of defaults should be applied in 1 year or whether a constant or variable proportion of the assumption value should be allocated to each year. The allocation of cash flows over time is the selected model form and is just as influential as the cash flow assumptions.

Case level each individual loan or guarantee within a cohort.

Cash flow stream the agency's projection of the dollar amount for the scheduled cash flows and deviations from scheduled cash flow items for each year over the life of the cohort.

Cash flows Estimates of payments to or from the Government over the life of a loan or group of loans or loan guarantees. For direct loans, these may include: loan disbursements, repayments of principal, payments of interest, and any other payments such as prepayments, fees, penalties, and other recoveries. For loan guarantees, these may include: payments by the Government to

cover defaults and delinquencies, interest subsidies, payments to the Government, such as origination and other fees, penalties and recoveries, and any other payments.

Cohort

all direct loans or loan guarantees of a program for which a subsidy appropriation is provided for a given fiscal year, even if disbursements occur in subsequent years. For direct loans and loan guarantees for which a subsidy appropriation is provided for one fiscal year, the cohort will be defined by that fiscal year. For direct loans and loan guarantees for which multi-year or no-year appropriations are provided, the cohort will be defined by the year of obligation.

Direct Loan Subsidy Allowance Account

the balance maintained in the general ledger that represents the difference between the current outstanding loans receivable balance and the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the direct loans. The subsidy allowance is subtracted from the loans receivable balance when calculating the net loans receivable balance. A similar account may also be used for defaulted guaranteed loans.

Econometrics

the application of statistical methods to the estimation of economic relationships.

Financing Account

the non-budgetary account or accounts associated with each credit program account that holds 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. Each program account is associated with one or more financing accounts, depending on whether the account makes both direct loans and loan guarantees (separate financing accounts are required for direct loans and loan guarantees).

Fund

an aggregation of programs into a common grouping consistent with how the Congress provides appropriations - i.e., the program and financing accounts together and, if needed, the negative subsidy receipt accounts. (This term has other meanings in different contexts.)

Inputs	in the context of Federal credit, cash flow data elements used to develop spreadsheet calculations.
Internal control	an integral component of an organization's management that provides reasonable assurance regarding the achievement of reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations. Internal control consists of the control environment, risk assessment, control activities, information and communication and monitoring.
Key assumptions	assumptions that have been established, through sensitivity analysis or other means, to be the elements that have a large impact on estimates, and thus are the most important factors in determining the cost of a loan or group of loans or loan guarantees.
Liability for Loan Guarantees Account	the balance maintained in the general ledger that represents the present value of estimated cash outflows minus the present value of the estimated cash inflows over the remaining life of the loan guarantees.
Liquidating Account	the budget account that includes all cash flows to and from the Government resulting from <u>pre-1992</u> direct loans or loan guarantees, unless they have been modified and transferred to a financing account.
Negative Subsidy Receipt Account	the budget account for the receipt of amounts paid from the financing account when there is a negative subsidy cost for the original estimate or a downward reestimate. For mandatory programs, negative subsidies and downward reestimates may be credited directly to the program account as offsetting collections from non-Federal sources.
OMB Credit Subsidy Calculator	computer software developed by OMB for discounting cash flows in estimating credit subsidies. It uses agency cash flow inputs to compute the net present value at the point of disbursement and the subsidy rate associated with those cash flows.

Program in the context of Federal credit, an aggregation of cohorts which are linked by common terms, conditions, regulations, and/or mission goals; often a sub-division of a fund or the budgetary financing account.

Program Account the budget account into which an appropriation to cover the subsidy cost of a direct loan or loan guarantee program is made and from which such cost is disbursed to the financing account. Program accounts usually receive a separate appropriation for administrative expenses.

Risk category subdivisions of a cohort of direct loans or loan guarantees into groups of loans that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all loans obligated or committed for a program during the fiscal year that share characteristics predictive of defaults or other costs. All cohort level guidance in this technical release also applies to risk categories when they are used.

Service or line of business an aggregation of funds into a common grouping: for example, grouping funds into single family or multifamily designations. The following example is provided to illustrate the relationship the above terms have to each other and show how they may be aggregated for financial statement purposes. Agencies should consult applicable OMB guidance to determine what level of aggregation is most appropriate and acceptable.

Business line or service: Farm Service Agency

Fund:

- A. CCC Export Guarantees
- B. Agricultural Credit Insurance Fund

Program:

- B1. Farm Ownership Loans
- B2. Farm Operating Loans, subsidized
- B3. Farm Operating Loans, unsubsidized

Cohort:

- B3a. FY 1992 Farm Operating Loans, unsubsidized
- B3b. FY 1993 Farm Operating Loans, unsubsidized
- B3c. FY 1994 Farm Operating Loans, unsubsidized
- B3d. FY 1995 Farm Operating Loans, unsubsidized
- B3e. FY 1996 Farm Operating Loans, unsubsidized

Risk category:

- B3e1. FY 1996 Farm Operating Loans, unsubsidized, Southwest Region
- B3e2. FY 1996 Farm Operating Loans, unsubsidized, Northeast Region

Case:

- B3ai Fiscal year 1992 unsubsidized loan to farmer A
- B3aiaii Fiscal year 1992 unsubsidized loan to farmer B

Appendix B: Summary of Selected Reporting Requirements¹⁹

Principal Statements	Credit Reform Information Presented
Balance Sheet	Credit program receivables and related foreclosed property, net of related subsidy allowance Liabilities for loan guarantees
Statement of Net Cost	Subsidy expense will be included as part of the gross program costs (present value of fees will be included as an offset in calculating subsidy expense rather than recording actual collection of fees as revenue) Interest revenue and interest expense
Statement of Changes in Net Position	Appropriations received (subsidy) and appropriations used
Statement of Budgetary Resources	Appropriations received (subsidy), borrowing authority, offsetting collections (examples: Collection of fees, principal, interest, subsidy from program account) and obligations (subsidy to financing account, direct loans, interest supplements, default claims) and offsetting receipts (example: negative subsidy or downward reestimate received by general fund receipt account)
Statement of Financing	Reconcile net obligations to net cost using components from the Statements of Budgetary Resources, Changes in Net Position and Net Cost. Examples of reconciling items include upward/downward reestimates of subsidy expense, offsetting collections pertaining to fees and obligations

¹⁹ Refer to FASAB Standards for a complete listing of accounting and reporting requirements. The requirements in the Standards may be supplemented by guidance provided in OMB Bulletin 01-09 and OMB Circular A-11.

Note Disclosures

Direct Loans (and Defaulted Guaranteed Loans) by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09. SFFAS No. 18 requires the reconciliation of the subsidy cost allowance for direct loans and not defaulted guaranteed loans.

Guaranteed Loans by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09.

Both Direct Loans (and Defaulted Guaranteed Loans) and Guaranteed Loans by Program or Fund

*Presentation by Program or Fund required by OMB Bulletin 01-09. Comparative data (current and prior years) for Note disclosures required by OMB Bulletin 01-09.

Credit Reform Information Presented

By program or fund:

- Loans receivable gross,
- Interest receivable,
- Foreclosed property,
- Allowance for subsidy cost (present value), and
- Net value of assets related to direct loan programs (and loan guarantee programs)

Total amount of loans disbursed for current and prior years

Reconciliation between the beginning and ending balance of the subsidy cost allowance at the reporting entity level

By program or fund:

- Present value of post-1991 liabilities for loan guarantees
- Face value of guaranteed loans outstanding,
- Amount of outstanding principal guaranteed

Reconciliation between the beginning and ending balance of the loan guarantee liability at the reporting entity level

By program or fund:

- Total subsidy expense, and its components
- Total subsidy expense for modifications
- Total subsidy expense for reestimates, and their components, for current and prior year (interest and technical)
- Subsidy rates for the total subsidy cost, and its components, for the current year
- Total administrative expense
- Description of the characteristics of loan programs
- Discussion of 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 reestimates
- Nature of the modification of direct loans or loan guarantees, discount rate used to calculate the modification expense, and basis for recognizing a gain or loss relating to the modification.
- Restrictions on the use/disposal of foreclosed property, number of properties held and average holding period by type or category, number of properties for which foreclosure proceedings are in process and changes from prior year's accounting methods

Staff Implementation Guidance 23.1: Guidance for Implementation of SFFAS 23, Eliminating the Category National Defense Property, Plant, and Equipment: Classification of Items Formerly Considered National Defense PP&E

Status

Issued	January 31, 2005
Effective Date	Effective upon issuance.
Volume II References	General Property, Plant and Equipment (G20)
Interpretations and Technical Releases	None.
Affects	SFFAS 23
Affected by	None.

Summary

The implementation guidance resolves an inconsistency between the implementation guidance provided in SFFAS 23 and definitions in existing standards.

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Background

1. Statement of Federal Financial Accounting Standards (SFFAS) 23, Eliminating the Category National Defense Property, Plant, and Equipment, rescinded SFFAS 11, Amendments to Accounting for Property, Plant, and Equipment - Definitional Changes in its entirety. SFFAS 11 established the definition of National Defense Property, Plant, and Equipment (ND PP&E). Its rescission eliminated the category ND PP&E along with the definition for that term. Implementing guidance contained in SFFAS 23 provides that:

10. The initial capitalization amount for assets previously considered ND PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6 [Accounting for Property, Plant, and Equipment], as amended, and should be the initial historical cost for the items, including any major improvements or modifications. (Emphasis added.)
2. The above text suggests that all items formerly considered ND PP&E should be classified as PP&E. In addition, par. II of SFFAS 23 provides that “all items previously considered ND PP&E are classified as general PP&E.” Par. 6b of SFFAS 23 also refers to classification as general PP&E.

Staff Implementation Guidance

3. **Q: Should par. 10 of SFFAS 23 limit the classification of items previously considered ND PP&E to general PP&E?**
4. A: No. A reasonable approach would be to subordinate SFFAS 23’s general implementation guidance to the definitions in accounting standards. That is, assets being recognized due to the implementation of SFFAS 23 should be categorized in accordance with asset definitions in SFFAS 6 and other accounting standards.
5. **Q: SFFAS 23 implementation guidance describes acceptable approaches to valuing those items of ND PP&E to be classified as general PP&E. How should items of ND PP&E not classified as general PP&E be valued?**
6. A: Any items not properly classified as general PP&E should be valued in a manner consistent with the general principles established in SFFAS 23 implementation guidance and the specific measurement guidance provided in accounting standards for the relevant asset class.

Basis for Conclusions

7. A literal application of SFFAS 23, par. 10 would result in de facto amendments to the PP&E definition contained in SFFAS 6 and any asset definitions promulgated by other standards. That is, all asset definitions other than general PP&E would have to exclude ND PP&E and the general PP&E definition would have to include ND PP&E.
8. Consequences of reading the implementation guidance as amending the definitions remaining in current standards include:
 - a. Inconsistency in classification of assets between the components of the Department of Defense and all other federal entities,
 - b. Possible inconsistent accounting for the items subject to implementation guidance in SFFAS 23 and items acquired in the future by the Department of Defense, and
 - c. Reliance on a definition that has been purged from authoritative publications such as the Original Pronouncements volume.
9. Staff implementation guidance resolves the inconsistency between the definitions and the implementation guidance by subordinating par. 10 of SFFAS 23 to asset definitions in accounting standards.

Effective Date

10. This guidance is effective upon issuance.

Appendix A: Topical Index

This index provides references to the topics in this Volume. References to the original statements are organized as follows: The first character indicates that it is a Concepts Statement (C), a Standards Statement (S), or an Interpretation (I), or a Technical Release (T). This letter is followed by a number to indicate which statement it refers to. The number is followed by a "P" for paragraph which is followed by the paragraph number(s).

In addition to accounting topics, the index lists certain agencies or programs that have been used in illustrations or that have unique provisions within the standards.

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SFFAS 27	Identifying and Reporting Earmarked Funds	9/30/2005
SFFAS 28	Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26	Upon issuance
SFFAS 29	Heritage Assets and Stewardship Land	9/30/2005
SFFAS 30	Inter-Entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts	9/30/2005
Technical Bulletin		Date Issued
2000-1	Federal Accounting Standards Advisory Board Technical Bulletin 2000-1	6/1/00
2002-1	Assigning to Component Entities Costs and Liabilities that Result from Legal Claims Against the Federal Government	7/1/02
2002-2	Disclosures Required by Paragraph 79(g) of SFFAS 7	9/1/02
2003-1	Certain Questions and Answers Related to the Homeland Security Act of 2002	6/1/03
Interpretations		Date Issued
I-1	Reporting on Indian Trust Funds	3/12/97
I-2	Accounting for Treasury Judgment Fund Transactions	3/12/97
I-3	Measurement Date for Pension and Retirement Health Care Liabilities	8/29/97
I-4	Accounting for Pension Payments In Excess of Pension Expense	12/19/97
I-5	Recognition by Recipient Entities of Receivable Nonexchange Revenue	12/98
I-6	Accounting for Imputed Intra-departmental Costs	6/00
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TR-3 (Revised)	Auditing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act – <i>Amendments to Technical Release No. 3 Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act</i>	1/04
TR-4	Reporting on Non-valued Seized and Forfeited Property	7/31/99
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Staff Implementation Guidance		Date issued
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SIG 23.1	Guidance for Implementing SFFAS 23, Eliminating the Category National Defense PP&E: Classification of Items formerly Considered National Defense PP&E	1/31/2006
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Appendix C: Memorandum of Understanding Among The General Accounting Office, The Department of The Treasury, and The Office of Management and Budget on Federal Government Accounting Standards and A Federal Accounting Standards Advisory Board

This Memorandum of Understanding reflects the agreement of the Government Accountability Office (“GAO”), the Department of the Treasury (“Treasury”), and the Office of Management and Budget (“OMB”) on the procedures to be followed in setting federal government accounting standards and the composition and operation of the Federal Accounting Standards Advisory Board.

Whereas GAO, Treasury, and OMB conduct a continuous program for improving accounting and financial reporting in the federal government; and

Whereas the Comptroller General, the Secretary of the Treasury, and the Director of the Office of Management and Budget established an advisory board under the Federal Advisory Committee Act, as amended (5 U.S.C. App.), to consider and recommend accounting concepts and standards for the federal government;

The Comptroller General, the Secretary of the Treasury, and the Director of the Office of Management and Budget (the Sponsors) each hereby agree to continue and serve as sponsors of the Federal Accounting Standards Advisory Board (“Board”). The Board will work under the general oversight of its Sponsors. In addition, the Sponsors each hereby agree to take related actions regarding federal government accounting standards. The Board shall be established as follows:

Section 1. Establishment.

A. Composition. The Board shall have the following ten members:

- one GAO member,
- one OMB member,
- one Treasury member,
- one member from the Congressional Budget Office (CBO), and
- six non-federal members selected from the general financial community, the accounting and auditing community, and academia.

B. Selections and Appointments. The GAO, OMB, Treasury and CBO members will be selected by their respective agencies. The six non-federal members will be selected by the Sponsors. In selecting the non-federal members, the Sponsors shall:

(1) seek nominations from a wide variety of sources, including the Director of CBO;

(2) consider, among other criteria, an individual's

(A) broad professional background, and

(B) expertise in federal government accounting, financial reporting, and financial management; and consider the recommendations of a panel convened by the chairperson.

The Sponsors will select a chairperson, who will be a non-federal member. At least one Sponsor shall obtain the view of the Director of CBO before any appointments or selections of non-federal members are made.

- C. Tenure. The GAO, OMB, Treasury and CBO members shall serve at the discretion of their respective agency heads. The six non-federal members will serve initial terms of up to five years with a possible reappointment for one additional term of up to five years.
- D. Duties. The Board will consider accounting concepts and standards. The Board will not set or propose budget concepts, standards, and principles. In considering accounting concepts and standards, consideration will be given to the budgetary information needs of executive agencies and the needs of users of Federal financial information. Board recommendations on accounting concepts or standards will be submitted to the Comptroller General, the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Director of the Congressional Budget Office.
- E. Meetings and Agendas. The Board will meet whenever necessary or at the request of the Comptroller General, the Secretary of the Treasury, or the Director of OMB, and will establish detailed working procedures. Board members will be expected to attend all meetings.
- F. Funding. The Sponsors shall share in funding the Board on an equitable basis. The Director of CBO shall fund the Board to the same extent as the Secretary of the Treasury.

Section 2. Support Staff and Other Groups.

- A. Staff. A core group of qualified technical staff will support the Board in carrying out its duties and functions. The staff will spend its time working on Board matters and, from time to time, may be augmented with staff assigned from government departments or agencies or other organizations.
- B. Task Forces. The Board may appoint task forces as necessary to advise it on a variety of accounting matters. Task forces will play an important role in the accounting standard-setting process. They will provide expert views and recommend solutions to issues or problems. A task force shall include a CBO member if the Director of CBO wishes to participate in the task force and concludes that CBO has expertise in the issue or problem being addressed.

Section 3. Accounting Standard-Setting Process. The Board will follow a six-step process for considering accounting standards. The steps in the process are:

- (1) Identification of accounting issues and agenda decisions,
- (2) Preliminary deliberations,

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- (3) Preparation of initial documents (issues papers and/or discussion memorandums),
 - (4) Release of documents to the public, public hearings, and considerations of comments,
 - (5) Further deliberations, exposure draft, and consideration of comments, and
 - (6) General consensus (at least a majority vote) reached among Board members and documents submitted to the Comptroller General, the Secretary of the Treasury, the Director of OMB and the Director of CBO.

The Board will determine the detailed procedures necessary to implement these steps.

Section 4. Concepts and Standards. Concepts and standards provide a frame of reference for resolving accounting issues.

When the Board has developed a proposed concept or standard, the Board shall submit it to the Comptroller General, the Director of OMB, the Secretary of the Treasury and the Director of CBO for their review. If, within 90 days after its submission, the Comptroller General or the Director of OMB, or both, objects to the concept or standard, then it shall not be issued and will be returned to the Board for further consideration. If, within 90 days after its submission, neither of these officials objects to the concept or standard, then it shall be issued and become a final concept or standard of the Board. Concepts and standards will be announced in *The Federal Register*.

A proposed Interpretation or Technical Release shall be submitted to the members of the Board representing the three Sponsors for their review. If, within 45 days after its submission, any one of the members representing a Sponsor objects to the proposed Interpretation or Technical Release, then it shall be returned to the Board for further consideration. If, within 45 days after its submission, none of these officials objects to the Interpretation or Technical Release, then it shall become final. Final Interpretations and Technical Releases will be announced in *The Federal Register*.

The Sponsors agree that standards set and promulgated following the Board's Rules of Procedure are recognized to have substantial authoritative support, and those accounting standards contrary to such promulgation are not. The Sponsors retain their authorities, separately and jointly, to establish and adopt accounting standards for the federal government.

Section 5. Transition. Each of the non-federal members serving on January 11, 2002 shall have their current term extended to June 30, 2004, and be eligible for an additional term of up to five years to the extent total service on the Board does not exceed 10 years.

Section 6. Termination. Any modification to this memorandum shall be effective if agreed to by each of the three signatory agencies. This memorandum shall remain in effect until 120 days after one of the Sponsors provides notice of intent to terminate the agreement.

Section 7. Effective Date. This memorandum of understanding is effective when executed by the Sponsors except that provisions involving the Congressional Budget Office will become effective on October 1, 2003.

/s/ _____

John W. Snow
Secretary of the Treasury

_____ May 7, 2003

/s/ _____

Mitchell Daniels
Director, Office of Management
and Budget

_____ May 7, 2003

/s/ _____

David M. Walker
Comptroller General of the
United States

_____ May 7, 2003

Appendix D: Federal Accounting and Auditing Resources

[This appendix lists sources where one can get individual documents that are issued between updates of the Codification. These and other relevant resources are listed here.]

FASAB -- www.fasab.gov

Office of Management and Budget -- www.whitehouse.gov/omb

Government Accountability Office -- www.gao.gov

Treasury Financial Management Service -- www.fms.treas.gov

Appendix E: Consolidated Glossary

This glossary is a compilation of all terms presented in Statements of Federal Financial Accounting Standards. Some terms are designated as “Special Term from SFFAS #” and are terms defined specifically for the standard indicated. These terms are not intended for general application to other federal financial transactions.

Abandoned Property

Property of any type over which the rightful owner has relinquished possession and any claim of an ownership interest, without assertion of an adverse right to possession and control by the federal government. This would include property left at a government facility and unclaimed by the rightful owner following notice of intent to dispose. This property is a type of seized property.

Abatement

A reduction or cancellation of an assessed tax.

Accountability Reports

These reports are broader in scope than traditional general purpose financial reports. As explained by OMB: “Six pilot agencies volunteered to produce an ‘Accountability Report’ for FY 1995 to provide more useful information to decision makers by linking together information required by several management statutes. . . . Accountability Reports integrate the following information: the FMFIA report, the CFOs Act Annual Report (including audited financial statements); management’s Report on Final Action as required by the IG Act; Civil Monetary Penalty and Prompt Payment Act reports; and available information on agency performance compared with its stated goals and objectives, in preparation for implementation of GPRA.” *Federal Financial Management Status Report and Five Year Plan*, June 1996, pages 33-34. Twelve agencies produced accountability reports for FY 1997; eighteen plan to do so for FY 1998; the number will increase to 23 for FY 2000. (The requirement to include Civil Monetary Penalty and Prompt Payment Act reports has been deleted.)

Accrual Accounting

Records the effects on a reporting entity of transactions and other events and circumstances in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the entity. Accrual accounting is concerned with an entity’s acquiring of goods and services and using them to produce and distribute other goods and services. It recognizes that the buying,

producing, selling, distributing, and other operations of an entity during a period, as well as other events that affect entity performance, often do not coincide with the cash receipts and payments of the period. Compare with cash accounting. [See Financial Accounting Standards Board Statement of Financial Accounting Concepts (SFAC) No. 4, Objectives of Financial Reporting by Nonbusiness Organizations, paragraph 50, SFAC No. 6, Elements of Financial Statements, pars. 139-141, 144-5; and Congressional Budget Office, Glossary of Budgetary and Economic Terms, "Accrual Accounting."] (SFFAS 24)

Activity The actual work task or step performed in producing and delivering products and services. An aggregation of actions performed within an organization that is useful for purposes of activity-based costing.

Activity Analysis The identification and description of activities in an organization. Activity analysis involves determining what activities are done within a department, how many people perform the activities, how much time they spend performing the activities, what resources are required to perform the activities, what operational data best reflect the performance of the activities, and what customer value the activity has for the organization. Activity analysis is accomplished with interviews, questionnaires, observation, and review of physical records of work. It is the foundation for agency process value analysis, which is key to overall review of program delivery.

Activity-based Costing A cost accounting method that measures the cost and performance of process related activities and cost objects. It assigns cost to cost objects, such as products or customers, based on their use of activities. It recognizes the causal relationship of cost drivers to activities.

Actual Cost An amount determined on the basis of cost incurred including standard cost properly adjusted for applicable variance.

Actual Custody Physical possession and control of property by government personnel.

Actuarial Balance	The difference between the summarized cost rate and the summarized income rate over a given valuation period.
Actuarial Cost Methods	A recognized actuarial technique used for establishing the amount and the incidence of employer contributions or accounting charges for pension costs under a pension plan.
Actuarial Liability	A liability based on statistical calculations and actuarial assumptions (actuarial assumptions are conditions used to resolve uncertainties in the absence of information concerning future events affecting insurance, pension expenses, etc.).
Actuarial Present Value	The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions. (Actuarial Standards of Practice No. 4)
Actuarial Status	The status of a program based on statistical calculations and actuarial assumptions about future economic, demographic, and other conditions and events.
Aggregate Entry Age Normal	A system of applying the entry age normal actuarial cost methodology using aggregate population models or groups instead of applying it individual by individual.
Allocations	As used in the context of the federal budget, the amount of obligational authority transferred from one agency, bureau, or account that is set aside in a transfer appropriation account to carry out the purpose of the parent appropriation or fund. (JFMIP, <i>Project on Standardization of Basic Financial Information Requirements of Central Agencies</i> , dated October 1991, hereafter cited as JFMIP Standardization Project)

Allotment	A distribution made within an entity of amounts available for obligation. [See OMB Bulletin A-34, <i>Instructions on Budget Execution</i> , Section 11, Terms and Concepts, “Allotment.”]
Ammunition	A generic term that includes a great variety of devices designed and constructed to inflict damage upon enemy personnel or material by action of an explosive, pyrotechnic, or chemical agent.
Amortization	The gradual extinguishment of any amount over a period of time through a systematic allocation of the amount over a number of consecutive accounting periods such as the retirement of a debt by serial payments to a sinking fund.
Anticipated	The word “anticipated” is used in a broad, generic sense in this document. In this context the term may encompass both “probable” losses arising from events that have occurred, which should be recognized on the face of the basic or “principal” financial statements, as well as “reasonably possible” losses arising from events that have occurred, which should be disclosed in notes to those statements. “Anticipated” may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. (See below for definitions of “ <i>forecast</i> ” and “ <i>projection</i> .”)
Applied Research	Systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met.
Apportionment	A distribution made by OMB of amounts available for obligation in an appropriation or fund account into amounts available for specified time periods, programs, activities, projects, objects, or combinations thereof. The apportioned amount limits the obligations that may be incurred. (OMB <i>Circular A-34</i>)

Appropriation

In most cases, appropriations are a form of budget authority provided by law that permits federal agencies to incur obligations and make payments out of the Treasury for specified purposes. An appropriation usually follows enactment of authorizing legislation. An appropriation act is the most common means of providing budget authority, but in some cases the authorizing legislation itself provides the budget authority.

Assessments

Enforceable claims for nonexchange revenue for which specific amounts due have been determined and the person from whom the tax or duty is due has been identified. They include both self-assessments made by persons filing tax returns and assessments made by the collecting entities as a result of audits, investigations, and litigation. Although the term is normally used in connection with taxes, as used in this Statement (SFFAS 7) assessments also include determinations of amounts due for any other kind of nonexchange revenue. Specifically excluded from the definition of assessments, as used in this Statement, are compliance assessments. Compliance assessments, as defined by IRS and Customs, do not represent financial receivables.

Assets

Tangible or intangible items owned by the federal government which would have probable economic benefits that can be obtained or controlled by a federal government entity. (Adapted from Financial Accounting Standards Board, Statement of Concepts No. 6, *Elements of Financial Statements*)

Attribution

The process of assigning pension benefits or costs to periods of employee service. [Financial Accounting Standard Board, Statement of Financial Accounting Standard No. 87, *Employers' Accounting for Pensions*]

Assumptions

Basic beliefs about the future operating and functional characteristics. Types of assumptions include:

Actuarial: Assumptions as to the occurrence of future events affecting projected costs, such as mortality, withdrawal, disability, and future interest rates.

Cash flow assumptions - all known and/or forecasted information about the characteristics and performance of a cash flow, e.g., a loan or group of

loans or loan guarantees. Examples of assumptions pertaining to loans and loan guarantees include estimates of maturity, borrower interest rate, default/delinquency rate, timing of defaults, overall impact of changes in economic factors, etc.

Hospital assumptions: Assumptions related to medical treatment including differentials between hospital labor and nonlabor indices compared to general economy labor and nonlabor indices; rates of hospital admission; the trend toward treating less complicated cases in outpatient settings; and continued improvement in the classification of patients according to type of treatment, age, diagnosis, etc.

Key assumptions - Assumptions that have been established, through sensitivity analysis or other means, to be the elements that have a large impact on estimates, and thus are the most important factors in determining the cost of a loan or group of loans or loan guarantees.

Model assumptions - determinations of how cash flow assumptions are applied through the life of the cohort. For example, determining whether the entire assumed amount of defaults should be applied in 1 year or whether a constant or variable proportion of the assumption value should be allocated to each year. The allocation of cash flows over time is the selected model form and is just as influential as the cash flow assumption.

Social Security: Values relating to future trends in certain key factors. Demographic assumptions include fertility, mortality, net immigration, marriage, divorce, retirement patterns, disability incidence and termination rates, and changes in the labor force. Economic assumptions include unemployment, average earnings, inflation, interest rates, and productivity. Projections are normally provided based on the following three sets of economic assumptions • the “low cost” set (Alternative I) that assumes relatively rapid economic growth, low inflation, and demographic conditions favorable to the plan;

- the “intermediate cost” set (Alternative II) that represents the trustees’ “best estimate” of future trends; and
- the “high cost” set (Alternative III) that assumes slow economic growth, more rapid inflation, and demographic conditions unfavorable to the plan.

Authority To Borrow

Authority to borrow is a subset of budget authority. (See *budget authority*.)

Avoidable Cost	A cost associated with an activity that would not be incurred if the activity were not performed.
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Basic Financial Statements	As used in SFFAS 7, the basic financial statements are those on which an auditor would normally be engaged to express an opinion. The term “basic” does not necessarily mean that other financial information not covered by the auditor’s opinion is less important to users than that contained in the basic statements; it merely connotes the expected nature of the auditor’s review of, and association with, the information. The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the “principal financial statements.” The Form and Content of these statements are determined by OMB. (see also Principal Financial Statements)
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Basic Research	Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind.
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Betterment	An expenditure having the effect of extending the useful life of an existing asset, increasing its normal rate of output, lowering its operating cost, increasing rather than merely maintaining its efficiency or otherwise adding to the worth of benefits it can yield. A betterment is distinguished from repair or maintenance in that the latter have the effect of merely keeping the asset in its customary state of operating efficiency without the expectation of added future benefits.
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Black Lung Benefits Program	<p>The Black Lung program consists of two parts: Part B and Part C. Recipients who filed claims from 1970 to mid-1973 are covered by Part B; all other recipients are covered by Part C.</p> <ul style="list-style-type: none">• Part B is currently administered by the Social Security Administration (SSA). Former coal miners and their dependents are eligible for monthly cash benefits if the miner is totally disabled or died due to black lung disease. Benefits under Part B are reduced if the beneficiary receives state workers’ compensation, unemployment compensation, or state disability compensation. Certain pension benefits are subject to an excess-earnings test. The
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program is wholly funded by annual appropriations from the general fund.

- Part C is administered by the U.S. Labor Department, although some services are provided by SSA on a reimbursable basis. The program serves a declining population. Increased mechanization of coal mining operations and the industry's improved health and safety regulations have resulted in very few new entrants into the program. Most current beneficiaries entered the program in the 1970s. Former coal miners who have black lung disease are eligible for Part C benefits if a responsible mine owner cannot be determined. Two-thirds of Part C benefits are funded by earmarked excise taxes on coal and one-third by general fund revenues. The latter takes the form of "repayable advances" rather than appropriations.

Book Value

The net amount at which an asset or liability is carried on the books of account (also referred to as carrying value or amount). It equals the gross or nominal amount of any asset or liability minus any allowance or valuation amount.

Budget

The Budget of the United States Government setting forth the President's comprehensive financial plan for allocating resources. The Government uses the budget system to allocate resources among its major functions and individual programs. The budget process has three main phases: formulation, congressional action on the budget, and execution. Some presentations in the budget distinguish between "on-budget" and "off-budget" totals. "On-budget" totals reflect the transactions of all Government entities except those excluded from the unified budget totals by law. Likewise, "off-budget" totals reflect the transactions of Government entities that are excluded from the unified budget totals by law. Currently excluded are the social security trust funds and the Postal Service Fund. The on- and off-budget totals are combined to derive unified or consolidated totals for Federal activity. The budget amounts and references in this exposure draft refer to the unified budget. [See FY 2003 *Budget of the United States Government: Analytical Perspectives*, "Budget System and Concepts and Glossary."]

Budget Authority

The authority provided by Federal law to incur financial obligations that will result in immediate or future outlays. Specific forms of budget authority include:

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- Appropriations -- which may be provided in appropriations acts or other laws and which permit obligations to be incurred and payments to be made;
 - Borrowing authority -- which permits obligations to be incurred but requires funds to be borrowed to liquidate the obligation;
 - Contract authority -- which permits obligations to be incurred but requires a subsequent appropriation or offsetting collections to liquidate the obligations; and
 - Spending authority from offsetting collections -- which permits offsetting collections to be credited to an expenditure account and permits obligations and payments to be made using the offsetting collections (the offsetting collections credited to an account are deducted from gross budget authority of the account.)

Budget authority may be classified by period of availability (one year, multiple-year, or no year), by nature of the authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections). (OMB *Circular A-11, Preparation and Submission of Budget Estimates*, Executive Office of the President, Office of Management and Budget, hereafter cited as OMB *Circular A-11*; OMB, *The Budget System and Concepts*; and GAO, *A Glossary of Terms Used in the Federal Budget Process*, Exposure Draft, January 1993; hereafter referred to as GAO *Budget Glossary*.)

Budget Obligation See Obligation below.

Budget Outlay See Outlay below.

Budget Receipt See Receipt below.

Budget Surplus Or
Deficit, Unified The unified budget surplus is the excess of budget receipts over budget outlays during a fiscal year and a deficit is the excess of budget outlays over budget receipts during a fiscal year. [See *FY 2003 Budget of the United States Government: Analytical Perspectives*, “Budget System and Concepts and Glossary.”] (SFFAS 24)

Budget, Unified	The budget presents combined on- and off-budget totals to derive totals for Federal activity, which is sometimes called the unified budget. The off-budget receipts and outlays of the Social Security trust funds and the Postal Service Fund are added to the on-budget receipts and outlays to calculate the unified budget totals.
Budgetary Accounting	Budgetary accounting is the system that measures and controls the use of resources according to the purposes for which budget authority was enacted; and that records receipts and other collections by source. It tracks the use of each appropriation for specified purposes in separate budget accounts through the various stages of budget execution from appropriation to apportionment and allotment to obligation and eventual outlay. This system is used by the Congress and the Executive Branch to set priorities, to allocate resources among alternative uses, to finance these resources, and to assess the economic implications of federal financial activity at an aggregate level. Budgetary accounting is used to comply with the Constitutional requirement that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations Made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public money shall be published from time to time.” (See Statement of Federal Financial Accounting Concepts No. 1, <i>Objectives of Federal Financial Reporting</i> , September 1993, Paragraphs 45-46, 112-114, and 186-191.)
Budgetary Resources	The forms of authority given to an agency allowing it to incur obligations. Budgetary resources include the following: new budget authority, unobligated balances, direct spending authority, and obligation limitations. (<i>GAO Budget Glossary</i>)
Business Type Activity	Significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue.
Capital Leases	Leases that transfer substantially all the benefits and risks of ownership to the lessee.
Capitalize	To record and carry forward into one or more future periods any expenditure the benefits or process from which will then be realized.

Cash Accounting	A system of accounting in which revenues are recorded when received in cash and expenses or expenditures are recorded when cash is disbursed. [See Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 4, <i>Objectives of Financial Reporting by Nonbusiness Organizations</i> , paragraph 50; and Congressional Budget Office, <i>Glossary of Budgetary and Economic Terms</i> , “Cash Accounting.”] (SFFAS 24)
Cash Flow Stream	The agency’s projection of the dollar amount for the scheduled cash flows and deviations from scheduled cash flow items for each year, e.g., over the life of a cohort of loans.
Cash Flows	Estimates or payments to or from the Government. For example, for direct loans, these may include: loan disbursements, repayments of principle, payments of interest, and any other payments such as defaults, prepayments, fees, penalties, and other recoveries. For loan guarantees, these may include: payments by the government to cover defaults and delinquencies, interest subsidies, payments to the government, such as origination and other fees, penalties and recoveries, and any other payments.
Central Fund	A federal entity established to finance the costs of seizure, management and disposition of property seized for forfeiture, and to receive any proceeds from the sale or other disposition of that property.
Changes In Accounting Principles	A change in accounting principle is a change from one generally accepted accounting principle to another one that can be justified as preferable. For the purposes of SFFAS 21, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards. (SFFAS 21)
Cleanup Costs	The costs of removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E.

Closed Group	See “ <i>Closed group (to new entrants)</i> .”
Closed Group (To New Entrants)	Those persons who, as of a valuation date, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.
Cohort	Those direct loans obligated or loan guarantees committed by a program in the same year even if disbursements occur in subsequent years. Post-1991 direct loans or loan guarantees will remain with their original cohort throughout the life of the loan, even if the loan is modified. Pre-1992 loans and loan guarantees that are modified shall each, respectively, constitute a single cohort. (OMB <i>Circular A-11</i>)
Collateral	Real or personal property pledged as part or full security on a debt.
Collections	Amounts received by the federal government during the fiscal year. Collections are classified as follows:-- Budget receipts or off-budget receipts are collections from the public based on the government’s exercise of its sovereign powers, including collections from participants in compulsory social insurance programs. -- Offsetting collections are collections from government accounts (intragovernmental transactions) or from the public that are offset against budget authority and outlays rather than reflected as receipts in computing the budget and off-budget totals. They are classified as (a) offsetting receipts (i.e., amounts deposited to receipt accounts), and (b) collections credited to appropriation or fund accounts. The distinction between these two major categories is that collections credited to appropriation or fund accounts are offset within the account that contains the associated disbursements (outlays), whereas offsetting receipts are in accounts separate from the associated disbursements. Offsetting collections are deducted from gross disbursements in calculating net outlays. (Based on <i>A Glossary Of Terms Used in the Federal Budget Process; and Related Accounting, Economic, and Tax Terms</i> , Third Edition, General Accounting Office, March 1981.)

Common Cost	The cost of resources employed jointly in the production of two or more outputs and the cost cannot be directly traced to any one of those outputs.
Common Data Source	All of the financial and programmatic information available for the budgetary, cost, and financial accounting processes. It includes all financial and much non-financial data, such as environmental data, that are necessary for budgeting and financial reporting as well as evaluation and decision information developed as a result of prior reporting and feedback.
Component Entities	The term “component entity” is used to distinguish between the U.S. Federal Government and its components. The U.S. Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, <i>Entity and Display</i> , pars. 11-12). Use of “component entity” in this standard is only intended to distinguish between the U.S. Federal Government’s consolidated financial statements and financial statements of its components.
Composite Depreciation Methodology	The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives.
Condition	The physical state of an asset. The condition of an asset is based on an evaluation of the physical status/state of an asset, its ability to perform as planned, and its continued usefulness. Evaluating an asset’s condition requires knowledge of the asset, its performance capacity and its actual ability to perform, and expectations for its continued performance. The condition of a long-lived asset is affected by its durability, the quality of its design and construction, its use, the adequacy of maintenance that has been performed, and many other factors, including: accidents (an unforeseen and unplanned or unexpected event or circumstance), catastrophes (a tragic event), disasters (a sudden calamitous event bringing great damage, loss, or destruction), and obsolescence.

Condition Assessment Surveys	Periodic inspections of PP&E to determine their current condition and estimated cost to correct any deficiencies.
Constant Dollar	A dollar value adjusted for changes in the average price level. A constant dollar is derived by dividing a current dollar amount by a price index. The resulting constant dollar value is that which would exist if prices had remained at the same average level as in the base period. Any changes in such constant dollar values would therefore reflect only changes in the real volume of goods and services, not changes in the price level. Constant dollar figures are commonly used to compute the real value of the gross domestic product and its components and to estimate the real level of Federal receipts and outlays. (GAO <i>Budget Glossary</i>)
Constructive Custody	Legal possession of property by federal government personnel through a non-federal agent, such as a commercial contractor or state or local official, under a legal agreement or court order that the agent maintains physical possession and control of the property on behalf of, and subject to the orders of, the Federal government personnel.
Contributions	Also referred to as “taxes,” “payroll taxes,” or “premiums,” these terms refer to amounts paid into social insurance programs. The payments can be paid by (1) employers and employees based on wages from employment covered under a program; (2) the self-employed based on net earnings from selfemployment; (3) governments based on wages of state and local government employees; and (4) policyholders based on coverage under certain programs.
Consumption Method	A method of accounting for goods, such as materials and supplies, where the goods are recognized as assets upon acquisition and are expensed as they are consumed.
Contingency	An existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.

Contra Account	One of two or more accounts which partially or wholly offset another or other accounts; on financial statements, they may be either merged or appear together.
Contract Authority	Contract authority is a subset of budget authority. (See <i>budget authority</i> .)
Controllable Cost	A cost that can be influenced by the action of the responsible manager. The term always refers to a specified manager since all costs are controllable by someone.
Cost	Defined in SFFAC No. 1, <i>Objectives of Federal Financial Reporting</i> as the monetary value of resources used (para. 195). Defined more specifically in SFFAS No. 4, <i>Managerial Cost Accounting Concepts and Standards for the Federal Government</i> , as the monetary value of resources used or sacrificed or liabilities incurred to achieve an objective, such as to acquire or produce a good or to perform an activity or service (page 105). Depending on the nature of the transaction, cost may be charged to operations immediately, i.e., recognized as an expense of the period, or to an asset account for recognition as an expense of subsequent periods. In most contexts within <i>Accounting for Revenue and Other Financing Sources</i> , “cost” is used synonymously with expense. See also “ <i>Full Cost</i> .”
Cost Allocation	A method of assigning costs to activities, outputs, or other cost objects. The allocation base used to assign a cost to objects is not necessarily the cause of the cost. For example, assigning the cost of power to machine activities by machine hours is an allocation because machine hours are an indirect measure of power consumption.
Cost Assignment	A process that identifies costs with activities, outputs, or other cost objects. In a broad sense, costs can be assigned to processes, activities, organizational divisions, products, and services. There are three methods of cost assignment: (a) directly tracing costs wherever economically feasible, (b) cause-and-effect, and (c) allocating costs on a reasonable and consistent basis.

Cost-benefit Analysis	The weighing of benefits against costs usually expressed as a ratio of dollar benefits to dollar costs for each of a variety of alternatives to provide a comparable basis of choice among them.
Cost Driver	Any factor that causes a change in the cost of an activity or output. For example, the quality of parts received by an activity, or the degree of complexity of tax returns to be reviewed by the IRS.
Cost Finding	Cost finding techniques produce cost data by analytical or sampling methods. Cost finding techniques are appropriate for certain kinds of costs, such as indirect costs, items with costs below set thresholds within programs, or for some programs in their entirety. Cost finding techniques support the overall managerial cost accounting process and can represent non-recurring analysis of specific costs.
Cost Object (Also Referred To As Cost Objective)	An activity, output, or item whose cost is to be measured. In a broad sense, a cost object can be an organizational division, a function, task, product, service, or a customer.
Cost Rate	The ratio of expenditures for the program to the taxable payroll for the year.
Covered Employment	All employment and self-employment creditable for purposes of the social insurance program. For Social Security, almost every kind of employment and self-employment is covered. In a few employment situations, coverage must be elected by the employer. Covered employment for HI includes all federal employees, whereas covered employment for OASDI includes some, but not all, federal employees.
Covered Worker	A person having earnings creditable for a social insurance program. For Social Security, “creditable earnings” are based on earnings taxable under the program. The number of HI covered workers is slightly larger than the number of OASDI covered workers because of different coverage status for federal employment.

Credit Program	For the purpose of this Statement (SFFAS 19), a federal program that makes loans and/or loan guarantees to nonfederal borrowers.
Current Discount Rate	With respect to the modification of direct loans or loan guarantees, it is the discount rate used to measure the cost of a modification. It is the interest rate applicable at the time of modification on marketable Treasury securities with a similar maturity to the remaining maturity of the direct or guaranteed loans, under either pre-modification terms, or post-modification terms, whichever is appropriate. [<i>Special Term from SFFAS 2</i>]
Current Liabilities	Amounts owed by a federal entity for which the financial statements are prepared, and which need to be paid within the fiscal year following the reporting date.
Current Services Assessment	Projections of future receipts and outlays from future activities based on the programs established by current law. The CSA focuses on the totality of Government operations rather than on individual programs, and shows the short- and long-term direction of current programs.
Custodial Agency	The federal agency that has actual possession of seized or forfeited property, or constructive possession of property through a non-federal agent. The custodial agency would be responsible for reporting material quantities of non-valued items.
Dedicated Collections (Or Taxes)	See “ <i>earmarked taxes.</i> ”
Default	The failure to meet any obligation or term of a credit agreement, grant, or contract. Often used to refer to accounts more than 90 days delinquent. (<i>Treasury Financial Manual Supplement</i>)

Deferred Maintenance	Maintenance that was not performed when it should have been or was scheduled to be and which, therefore, is put off or delayed for a future period.
Depreciation Accounting	The systematic and rational allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.
Development	Systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.
Differential Cost	The cost difference expected if one course of action is adopted instead of others.
Direct Cost	The cost of resources directly consumed by an activity. Direct costs are assigned to activities by direct tracing of units of resources consumed by individual activities. A cost that is specifically identified with a single cost object.
Direct Loan	A disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. (Adapted from OMB <i>Circular A-11</i>)
Directed Flows Of Resources	Expenses to nonfederal entities imposed by federal laws or regulations without providing federal financing. In the case of state and local governments, directed flows are known as “unfunded mandates.” The costs and financing of federal regulations do not flow through the Government, but their effects are similar to direct federal expenditures and revenue.
Disclosure	Reporting information in notes or narrative regarded as an integral part of the basic financial statement.

Discount	The difference between the estimated worth of a future benefit and its present value; a compensation for waiting or an allowance for returns from using the present value of these returns in other ways.
Discount Rate	An interest rate that is used in present value calculations to equate amounts that will be received or paid in the future to their present value.
Dividend Fund Interest Rate	The interest rate determined at policy issuance used to determine the amount of the dividend fund. It is the rate used to credit interest to the dividend fund, and against which experience is measured to determine the amount of the interest portion of dividends paid to individual policyholders. (AICPA Statement of Position 95-1, Glossary, p. 33]
Donated Capital	The amount of nonreciprocal transfers of assets or services from State, local, and foreign governments; individuals; or others not considered parties related to the Government. (JFMIP Standardization Project)
Drawbacks	Refunds of all or part of duties on imported goods that are subsequently exported or destroyed. Typically these arise when imported materials are used to manufacture a product that is later exported. In such cases, most of the duties originally paid are refundable when the finished product is exported.
Earmarked	Statutory dedication of specifically identified revenues and other financing sources to designated activities, benefits or purposes.
Earmarked Fund	Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes and must be accounted for separately from the Government's general revenues. The three required criteria for an earmarked fund are:

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- A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
 - Explicit authority for the earmarked funds to retain revenues and other financing sources not used in the current period for the future benefit of the designated activities, benefits, or purposes; and
 - A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

Earmarked Taxes

Taxes levied by the Government that are dedicated by law to finance a specific federal program.

Econometric Model

An equation or a set of related equations used to analyze economic data through mathematical and statistical techniques. Such models may be devised in order to depict the essential quantitative impact of alternative assumptions or government policies. (*Dictionary of Banking and Finance*, Jerry M. Rosenberg, Ph.D., Wiley & Sons, New York, 1982, hereafter cited as Rosenberg's Dictionary.)

Economic Life

The period during which a fixed asset is capable of yielding services of value to its owner. (See "*useful life*".)

End User

Any component of a reporting entity that obtains goods for direct use in its normal operations. The component may also be a contractor.

Entitlement Period

The period (such as, monthly) for which benefits become due.

Entitlement Program

A program in which the federal government becomes automatically obligated to provide benefits to members of a specific group who meet the requirements established by law.

Entity	A unit within the federal government, such as a department, agency, bureau, or program, for which a set of financial statements would be prepared. Entity also encompasses a group of related or unrelated commercial functions, revolving funds, trust funds, and/or other accounts for which financial statements will be prepared in accordance with OMB annual guidance on Form and Content of Financial Statements.
Entry Age Normal Actuarial Method	A method under which the actuarial present value of projected benefits of each employee is allocated on a level basis over the earnings or the service of the employee between entry age and assumed exit age. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion of this present value not provided for at a valuation date by the present value of future normal cost is called the actuarial accrued liability. The assumption is made under this method that every employee entered the plan (entry age) at the time of initial employment or at the earliest eligibility date, if the plan had been in existence, and that contributions have been made from the entry age to the date of the actuarial valuation. The term “aggregate entry age normal” refers to an approach whereby costs are determined for the group as a whole rather than for each individual participant separately.
Errors	Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. (SFFAS 21)
Estimated Cost	The process of projecting a future result in terms of cost, based on information available at the time. Estimated costs, rather than actual costs, are sometimes the basis for credits to work-in-process accounts and debits to finished goods inventory.
Event	A happening of consequence to an entity. It may be an internal event that occurs within an entity, such as the transforming of raw materials into a product. Or it may be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, theft, vandalism, a tort caused by negligence, or an accident. (Adapted from Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6, <i>Elements of Financial Statements</i>)

Exchange Revenue	Inflows of resources to a governmental entity that the entity has earned. They arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return.
Exchange Transaction	A transaction that arises when each party to the transaction sacrifices value and receives value in return.
Executory Contract	A contract which has not been performed by all parties to it. (Trascona, Joseph L., <i>Business Law</i> , William C. Brown C. Publishers, 1981)
Executory Cost	Those costs such as insurance, maintenance, and taxes incurred for leased property, whether paid by the lessor or lessee. (Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 13, <i>Accounting for Leases</i>)
Expected Value	A statistical measurement attribute that is the sum of the products of each potential outcome multiplied by the probability of that potential outcome.
Expended Appropriations	The dollar amount of appropriations used to fund goods and services received or benefits or grants provided.
Expenditure	With respect to provisions of the Antideficiency Act (31 U.S.C. 1513-1514) and the Congressional Budget and Impoundment Control Act of 1974 (2 U.S.C. 622(i)), a term that has the same definition as outlay. (<i>GAO Budget Glossary</i>)
Expense	Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period.

Expired Appropriations (Accounts)	Appropriation accounts in which the balances are no longer available for incurring new obligations because the time available for incurring such obligations has expired. (JFMIP Standardization Project)
Federal Entities (Units, Components)	See <i>entity</i> .
Fair Value (Or fair market value)	Value determined by bona fide bargain between well-informed buyers and sellers, usually over a period of time; the price for which an PP&E item can be bought or sold in an arm's length transaction between unrelated parties; value in a sale between a willing buyer and a willing seller, other than in a forced or liquidation sale; an estimate of such value in the absence of sales or quotations.
Fiduciary Activity	An activity that relates to the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.
Fiduciary Relationship	A fiduciary relationship exists when an authorized agent or entity of the Government accepts, recognizes, agrees to or consents to undertake fiduciary activity.
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. (OMB <i>Circular A-11</i> , and OMB <i>Circular A-34</i> , Instructions on <i>Budget Execution</i> , Credit Apportionment and Budget Execution, hereafter cited as OMB <i>Circular A-34</i> .)
First-in, First-out (FIFO)	A cost flow assumption; the first goods purchased or produced are assumed to be the first goods sold.

Fixed Cost	A cost that does not vary in the short term with the volume of activity. Fixed cost information is useful for cost savings by adjusting existing capacity, or by eliminating idle facilities. Also called Non-Variable Cost or Constant Cost.
Fixed Value Securities	Securities that have a known maturity or redemption value at the time of issue.
Forecast	The term “forecast” in this document refers to prospective financial information, including but not limited to prospective financial statements, based on management’s assumptions about future conditions and actions that are deemed probable during the period covered. Forecasts are distinguished from “projections,” which provide prospective financial information based on one or more hypothetical assumptions or sets of assumptions. The hypothetical assumptions used in projections relate to future conditions and actions that may occur, but which are not necessarily deemed probable to occur. Both forecasts and projections may contain a range.
Foreclosure	A method of enforcing payment of a debt secured by a mortgage by seizing the mortgaged property. Foreclosure terminates all rights that the mortgagor has in the mortgaged property upon completion of due process through the courts. (<i>Treasury Financial Manual Supplement</i>)
Full-absorption Costing	A method of costing that assigns (absorbs) all labor, material, and service/manufacturing facilities and support costs to products or other cost objects. The costs assigned include those that do and do not vary with the level of activity performed.
Full Cost	The total amount of resources used to produce the output. More specifically, the full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the responsibility segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity and by other reporting entities. (SFFAS No. 4, <i>Managerial Cost Accounting Concepts and Standards for</i>

the Federal Government, para. 89) All direct and indirect costs to any part of the Federal Government of providing goods, resources, or services. (OMB *Circular A-25*).

Fund “Fund” has more than one meaning. Depending on the context it may mean merely a resource as in "funds" available to pay an obligation. Or, for budgetary accounting, it may mean "Federal funds" or "trust funds," the two major groups of funds in the budget. The Federal funds include all transactions not classified by law as being in trust funds. The main financing component of the Federal funds group is referred to as the "General Fund," which is used to carry out the general purposes of Government rather than being restricted by law to a specific program and consists of all collections not earmarked by law to finance other funds.

General Fund Accounts for receipts not earmarked by law for a specific purposes, the proceeds of general borrowing, and the expenditure of these moneys. (OMB, *The Budget System and Concepts*)

General PP&E Land Land and land rights owned by the Federal Government that are acquired for or in connection with items of general PP&E.

General Purpose Financial Reports Reports intended to meet the common needs of diverse users who typically do not have the ability to specify the basis, form, and content of the reports they receive.

Good A tangible product produced to provide to a customer.

Government-acknowledged Events Events that are not a liability in themselves, but are those events that are “of financial consequence” to the federal government because it chooses to respond to the event.

Governmental Receipts Collections from the public that result primarily from the exercise of the Government's sovereign or governmental powers. Governmental receipts consist mostly of individual and corporation income taxes and social

insurance taxes but also include excise taxes, compulsory user charges, customs duties, court fines, certain license fees, gifts and donations, and deposits of earnings by the Federal Reserve System. They are compared to outlays in calculating a surplus or deficit. (OMB, *The Budget System and Concepts*)

Government-related
Events

Nontransaction-based events that involve interaction between federal entities and their environment.

Gross Domestic Product

The total dollar value of all goods and services produced by labor and property located in the United States, regardless of who supplies the labor or property.

Group Depreciation
Methodology

The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

Hazardous Waste

A solid, liquid, or gaseous waste, or combination of these wastes, which because of its quantity, concentration, or physical, chemical, or infectious characteristics may cause or significantly contribute to an increase in mortality or an increase in serious irreversible, or incapacitating reversible, illness or pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, disposed of, or otherwise managed.

Heritage Assets

Property, plant, and equipment that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic (e.g., aesthetic) importance; or, significant architectural characteristics.

Historical Cost

Initially, the amount of cash (or its equivalent) paid to acquire an asset; subsequent to acquisition, the historical amount may be adjusted for amortization.

Human Capital	Expenses incurred for education and training programs financed by the Federal Government for the benefit of the public and designed to increase or maintain national economic productive capacity.
Impacts	In the context of discussing performance measurement, SFFAC 1 defines “impacts” as the difference between what actually occurred and what would have occurred in the absence of a Government program. SFFAC 1, paragraph 206 notes that, to the extent feasible and practical, effectiveness evaluation should focus on program results or effects in the sense of “impacts.” Assessing impacts of Governmental action in this sense typically requires program evaluations or other techniques that transcend annual performance reporting, though these techniques often will avail of information in the annual performance reports. These evaluations often require several years of data, are expensive to conduct, and typically are not performed on an annual basis for a given program.
Imputed Financing	Financing provided to the reporting entity by another Government entity covering certain costs incurred by the former. For example, part of Federal employee retirement benefits have been paid by the Government’s central personnel office. A reporting entity would recognize the full accruing cost of the benefits as well as the imputed financing so provided. [See SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, paragraph 73.]
Imputed Inter-departmental Costs	The unreimbursed (i.e. non-reimbursed and under-reimbursed) portion of the full costs of goods and services received by the entity from a providing entity that is not part of the same department or larger reporting entity other than the U.S. government as a whole. (Interpretation 6)
Imputed Intra-departmental Costs	The unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, components or responsibility segments within the department or larger reporting entity). (Interpretation 6)
Income Rate	The ratio of contributions and tax income to taxable payroll for the year.

Incremental Cost	The increase or decrease in total costs that would result from a decision to increase or decrease output level, to add a service or task, or to change any portion of operations. This information helps in making decisions such as to contract work out, undertake a project, or increase, decrease, modify, or eliminate an activity or product.
Indirect Cost	A cost that cannot be identified specifically with or traced to a given cost object in an economically feasible way.
Internal Controls Insurance And Guarantee Programs	Federal government programs that provide protection to individuals or entities against specified risks. Because the federal government frequently commingles aspects of insurance and guarantees within the same program, this Statement (SFFAS 5) treats the terms as a single type of activity. (Also see <i>separate definition of social insurance</i>).
Inter-entity	A term meaning between or among different federal reporting entities. It commonly refers to activities or costs between two or more agencies, departments, or bureaus.
Interest	The service charge for the use of money or capital, paid at agreed intervals by the user, commonly expressed as an annual percentage of outstanding principal.
Interest Method	(1) Under the interest method of amortization, an amount of interest equal to the carrying amount of the investment times the effective interest rate is calculated for each accounting period. This calculated interest is the effective interest of the investment (referred to as “effective yield” in some literature). The effective interest is compared with the stated interest of the investment. (The stated interest is the interest that is payable to the investor according to the stated interest rate.) The difference between the effective interest and the stated interest is the amount by which the discount or the premium should be amortized (i.e., reduced) for the accounting period. (2) A method used to amortize the premium or discount of an investment in bonds, or, as used in SFFAS 2, to amortize the subsidy cost allowance of direct loans. Under this method, the amortization amount of the subsidy cost allowance equals the effective interest minus the

nominal interest of the direct loans times the effective interest rate (the discount rate). The nominal interest equals the nominal amount (face amount) of the direct loans times the stated interest rate (the rate stated in the loan agreements). [Special Term from SFFAS 2]

Interest Rate The price charged per unit of money borrowed per year, or other unit of time, usually expressed as a percentage.

Internal Control “Internal control” is a process, effected by an agency’s management and other personnel, designed to provide reasonable assurance that the objectives of the agency are being achieved in the following categories:

- Effectiveness and efficiency of operations including the use of the entity’s resources.
- Reliability of financial reporting, including reports on budget execution, financial statements, and other reports for internal and external use.
- Compliance with applicable laws and regulations. Internal controls consist of the control environment, risk assessment, control activities, information and communication, and monitoring. A necessary implication or subset of these objectives is the safeguarding of agency assets against unauthorized acquisition, use, or disposition.

Consequently, the definition of internal control, as it relates to safeguarding assets can be extended to include processes, effected by an agency’s management and other personnel, designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of the agency’s assets.” (From *Standards for Internal Control in the Federal Government*, Exposure Draft, U.S. GAO, December 1997.)

Intragovernmental Fund Revolving funds that conduct business-type operations primarily within and between Government agencies.

Job Order Costing A method of cost accounting that accumulates costs for individual jobs or lots. A job may be a service or manufactured item, such as the repair of equipment or the treatment of a patient in a hospital.

Land	Land is the solid part of the surface of the earth. Excluded from the definition of land are the natural resources (that is, depletable resources such as mineral deposits and petroleum; renewable resources such as timber, and the outer-continental shelf resources) related to land.
Last-in, First-out (LIFO)	A cost flow assumption; the last goods purchased are assumed to be the first goods sold.
Latest Acquisition Cost (LAC) Method	A method that provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use.
Latest Acquisition Cost	Includes all amounts, except interest, paid to a vendor to acquire an item.
Legacy Entity	An entity from which a smaller entity or specific function is being transferred. (Technical Bulletin 2003-1)
Liability	For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.
Life-cycle Costing	An acquisition or procurement technique which considers operating, maintenance, and other costs in addition to the acquisition cost of assets.
Liquidating Account	The budget account that includes all cash flows to and from the government resulting from pre-1992 direct loans or loan guarantees (those originally obligated or committed before Oct. 1, 1991), except those pre-1992 direct loans and loan guarantees that have been directly modified and transferred to a financing account. (See OMB <i>Circular A-11</i>)
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 nonfederal

borrower to a nonfederal lender but does not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions. (OMB *Circular A-11*)

**Loan Guarantee
Commitment**

A binding agreement by a federal agency to make a loan guarantee when specified conditions are fulfilled by the borrower, the lender, or any other party to the guarantee agreement. (OMB *Circular A-11*)

Loss

Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected.

**Lower Of Cost Or
Market**

A valuation rule that recognizes impairment of asset values but avoids anticipated gains. The rule is typically applied to individual items or groups of like items, such as inventory or marketable securities. In this rule, “cost” refers to historical cost and “market” refers to the current replacement cost by purchase or production.

Maintenance

The act of keeping fixed assets in usable condition. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, those originally intended.

**Managerial Cost
Accounting System**

The organization and procedures, whether automated or not, and whether part of the general ledger or stand-alone, that accumulates and reports consistent and reliable cost information and performance data from various agency feeder systems. The accumulated and reported data enable management and other interested parties to measure and make decisions about the agency’s/segment’s ability to improve operations, safeguard assets, control its resources, and determine if mission objectives are being met.

Marketable Treasury Securities

Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

Market-based Treasury Securities

Treasury securities issued to governmental accounts that are not traded on any securities exchange but mirror the prices of marketable securities with similar terms. (See *Treasury Financial Manual 2-4100*, Federal Agencies' Financial Reports, Exhibit No. 3.)

Market Value

(1) The estimated amount that can be realized by disposing of an item through arm's length transactions in the marketplace; the price (usually representative) at which bona fide sales have been consummated for products of like kind, quality, and quantity in a particular market at any moment of time. (2) For investments in marketable securities, the term refers to the value of such securities determined by prices quoted on securities exchange markets multiplied by the number of bonds or shares held in an investment portfolio.

Measurable

Can be determined with reasonable certainty or is reasonably estimable.

Medicare

A national, federally administered health insurance program authorized in 1965 to cover the cost of hospitalization, medical care, and some related services for most people over age 65, people receiving Social Security Disability Insurance payments for two years, and people with End-Stage Renal Disease. Medicare consists of two separate but coordinated programs: Part A, Hospital Insurance (HI) and Part B, Supplementary Medical Insurance (SMI). All persons entitled to HI are eligible to enroll in the SMI program on a voluntary basis by paying a monthly premium. Health insurance protection is available to Medicare beneficiaries without regard to income.

Military Missions

Functions performed by the Department of Defense or its component entities to prepare for the effective pursuit of war and military operations short of war; to conduct combat, peacekeeping, and humanitarian military operations; and to support civilian authorities during civil emergencies.

Model	A representation in mathematical symbols (or at least graphically) that depicts a formulated theory about the relationship among measurements of some phenomenon that varies. A model includes both cash flow assumptions and model assumptions.
Modeling	The process of developing and selecting an appropriate set of cash flows and model which generally have two aspects: (1) a choice of a general mathematical function (equation) describing a basic shape or process and (2) a choice of the model parameters that distinguish one specific shape from the general class of functional forms. The mathematical functions may take many forms. Commonly known examples of models are simple regression ($y=ax+b$), multiple regression ($y=ax+by+z$), and time series. Many other simple or more complex model forms related to cash flow modeling reform are possible.
Model Parameters	The values that identify a unique model from the general form. For example, $y=2x+3$ has parameters $a=2$ and $b=3$ for the simple regression model class. Note that “model parameter” is sometimes used in credit reform documents in lieu of the more appropriate term “input variable in the spreadsheet.”
Modification	A federal government action, including new legislation or administrative action, that directly or indirectly alters the estimated subsidy cost and the present value of outstanding direct loans (or direct loan obligations), or the liability of loan guarantees (or loan guarantee commitments). Direct modifications are actions that change the subsidy cost by altering the terms of existing contracts or by selling loan assets. Indirect modifications are actions that change the subsidy cost by legislation that alters the way in which an outstanding portfolio of direct loans or loan guarantees is administered. The term modification does not include subsidy cost reestimates, the routine administrative workouts of troubled loans, and actions that are permitted within the existing contract terms.
Modification Adjustment Transfer	A non-expenditure transfer from a financing account to the Treasury, or vice versa, to offset the difference between the cost of modification of direct loans (or loan guarantees) and the change in the book value of direct loans (or loan guarantee liabilities). (See also OMB <i>Circular A-11</i>)

Moving Average	An inventory costing method used in conjunction with a perpetual inventory system. A weighted average cost per unit is recomputed after every purchase. Goods sold are costed at the most recent moving average cost.
Multi-use Heritage Assets	Heritage assets whose predominant use is general government operations.
Negative Subsidy Account	the budget account for the receipt and/or expenditure of amounts paid from the financing account when there is a negative subsidy for the original estimate or a downward reestimate (not necessarily used for mandatory programs).
Net Cost Of Operations	Total costs incurred by the reporting entity less exchange revenue earned during the period. This is the “bottom line” of the statement of net costs. [See SFFAC 2, Entity and Display, pars. 86-99 and Appendix 1-B; and OMB Bulletin 01-09, Form and Content, Section 4.8, “Net Cost of Operations.”]
Net Level Premium Reserve	The excess, if any, of the present value of future guaranteed death endowment benefits over the present value of future net premiums. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contracts. (AICPA Statement of Position 95-1)
Net Operating Revenue (Or Cost)	At the CFR level, the difference between the net cost of operations and, essentially, all non-exchange revenue. (SFFAS 24)
Net Realizable Value	The estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal.

Nominal Dollar	The dollar value assigned to a good or service in terms of prices current at the time of the good or service is required. This contrasts with the value assigned to a good or service measured in constant dollars.
Nominal (Or Face Or Par) Value Or Amount	The amount of a bond, note, mortgage, or other security as stated in the instrument itself, exclusive of interest or dividend accumulations. The nominal amount may or may not coincide with the price at which the instrument was first sold, its present market value, or its redemption price. Often referred to as the stated value.
Nonexchange Revenue	Inflows of resources to the Government that the Government demands or that it receives by donations. The inflows that it demands include taxes, duties, fines, and penalties.
Nonexchange Transaction	A transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return.
Non-Federal Individuals or Entities	Individuals and entities acting in their private capacities outside of the authority and control of the Federal Government. Federal employees are "non-Federal individuals" when acting in their private capacities, e.g., with respect to their private retirement assets managed by a Federal plan.
Nonfederal Physical Property	Physical properties financed by grants from the Federal Government, but owned by state and local governments.
Normal Cost	That portion of the actuarial present value of pension plan benefits and expenses that is allocated to a valuation year by the actuarial cost method. (From Actuarial Standard of Practice No. 4)
Obligated Balances	The net amount of obligations in a given account for which payment has not yet been made. (JFMIP Standardization Project)

Obligation	Following the enactment of budget authority and the completion of required apportionment action, Government agencies incur obligations to make payments. Obligations are binding agreements that will result in outlays immediately or in the future. Obligations include, for example: current liabilities for salaries, wages, and interest; contracts for the purchase of supplies and equipment, construction, and the acquisition of office space, buildings, and land; and other arrangements requiring the payment of money. [See <i>FY 2003 Budget of the United States Government: Analytical Perspectives</i> , “Budget System and Concepts and Glossary“ (Obligations Incurred).]
Obligations	Amounts of orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payments during the same or a future period. (JFMIP Standardization Project)
Offsetting Collections	Collections from the public that result from business-type or market oriented activities and collections from other Government accounts. These collections are deducted from gross disbursements in calculating outlays, rather than counted in governmental receipts. Some offsetting collections are credited directly to appropriation or fund accounts; others, called offsetting receipts, are credited to receipt accounts. The authority to spend offsetting collections is a form of budget authority. (OMB, <i>The Budget System and Concepts</i>)
Offsetting Receipts	Offsetting receipts are a subset of offsetting collections. (See <i>collections</i> .)
OMB Credit Subsidy Model	Computer software developed by OMB for discounting cash flows in estimating credit subsidies. It uses agency cash flow inputs to compute the net present value at the point of disbursement and the subsidy rate associated with those cash flows.
Open Group Population	Those persons who are participating or who eventually will participate, during a specified period, in a social insurance program as contributors or beneficiaries. They include, for example, current workers, retirees, survivors, disabled persons, and new participants entering the workforce or

becoming beneficiaries, including those who will be born or immigrate to the United States in the future.

Operating Lease

An agreement conveying the right to use property for a limited time in exchange for periodic rental payments.

Opportunity Cost

The value of the alternatives foregone by adopting a particular strategy or employing resources in a specific manner. Also called Alternative Cost or Economic Cost.

Original Discount Rate

The discount rate originally used to calculate the present value of direct loans or loan guarantee liabilities, when the direct or guaranteed loans were disbursed. [*Special Term from SFFAS 2*]

Other Postemployment Benefits (OPEB)

Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans.

Other Retirement Benefits (ORB)

Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits. (Financial Accounting Standards Board, Statement of Financial Accounting Standard No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*)

Outcome

(1) Defined in broad terms in SFFAC No. 1 (para. 204-208) as accomplishments or results that occur (at least partially) because of the service efforts of Government entities. Some authorities use terms like "impact," "effect," or "results" to distinguish the change in outcomes specifically caused by the Government activity from the total change in conditions that can be caused by many factors. (2) Defined in SFFAS No. 8 as an assessment of the results of a program compared to its intended purpose. They shall: 1) be capable of being described in financial,

economic, or quantitative terms; and 2) provide a plausible basis for concluding that the program has had or will have this intended effect. For measuring outcomes for research and development programs, results may be reported by a narrative discussion of the major results achieved by the program during the year. (See SFFAS No. 8, *Supplementary Stewardship Reporting*, para. 93 & 99, and SFFAC No. 1, *Objectives of Federal Financial Reporting*, paras. 204-208, for further discussion of outcome.)

Outlay

The issuance of checks, disbursement of cash, or electronic transfer of funds made to liquidate a Federal obligation. Outlays also occur when interest on the Treasury debt held by the public accrues and when the Government issues bonds, notes, debentures, monetary credits, or other cash-equivalent instruments in order to liquidate obligations. Also, under credit reform, the credit subsidy cost is recorded as an outlay when a direct or guaranteed loan is disbursed. (GAO *Budget Glossary*)

Output

A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. They shall have two key characteristics: 1) they shall be systematically or periodically captured through an accounting or management information system, and 2) there shall be a logical connection between the reported measures and the program's purpose.

Output Measure

A tabulation, calculation, or recording of activity or effort that can be expressed in a quantitative or qualitative manner. It shall have two key characteristics: 1) it shall be systematically or periodically captured through accounting or management information system, and 2) there shall be a logical connection between the reported measures and the program's purpose.

Performance Measurement

A means of evaluating efficiency, effectiveness, and results. A balanced performance measurement scorecard includes financial and nonfinancial measures focusing on quality, cycle time, and cost. Performance measurement should include program accomplishments in terms of outputs (quantity of products or services provided, e.g., how many items efficiently produced?) and outcomes (results of providing outputs, e.g., are outputs effectively meeting intended agency mission objectives?). See Statement of

Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, para. 192.

Post-1991 Direct Loans	Direct loans obligated after September 30, 1991. [<i>Special Term from SFFAS 2</i>]
Post-1991 Loan Guarantees	Loan guarantees committed after September 30, 1991. [<i>Special Term from SFFAS 2</i>]
Post-modification Liability	The present value of the net cash outflows of the loan guarantees estimated at the time of modification under the post-modification terms, and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under post-modification terms (simply stated, the post-modification terms at the current rate). (<i>Special Term from SFFAS 19</i>)
Post-modification Value	The present value of the net cash inflows of direct loans estimated at the time of modification under post-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under post-modification terms (simply stated, the post-modification terms at the current rate). (<i>Special Term from SFFAS 19</i>)
Pre-modification Value	The present value of the net cash inflows of direct loans estimated at the time of modification under pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the direct loans under pre-modification terms (simply stated, the pre-modification terms at the current rate). (<i>Special Term from SFFAS 19</i>)

Pre-modification Liability	The present value of the net cash outflows of loan guarantees estimated at the time of modification under the pre-modification terms and discounted at the interest rate applicable to the time when the modification occurs on marketable Treasury securities that have a comparable maturity to the remaining maturity of the guaranteed loans under pre-modification terms (simply stated, the pre-modification terms at the current rate). (<i>Special Term from SFFAS 19</i>)
Pre-1992 Loan Guarantees	Loan guarantees committed before October 1, 1991. [<i>Special Term from SFFAS 2</i>]
Pre-1992 Direct Loans	Direct loans obligated before October 1, 1991. [<i>Special Term from SFFAS 2</i>]
Premium Deficiency	A condition under which a liability for future policy benefits using current conditions exceeds the liability for future policy benefits using contract conditions. In such cases, the difference should be recognized as a charge to operations in the current period.
Present Value (PV)	The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest. (Adapted from Kieso and Weygandt, <i>Intermediate Accounting</i> , 7th ed., p. 264.)
Principal Financial Statements	See SFFAC 2, paragraph 74, for a listing of the financial statements and other information that a financial report should include. The FASAB considers principal financial statements an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information. [SFFAC 2, <i>Entity and Display</i> , paragraph 71, footnote 12.] (See also Basic Financial Statements)
Probable	That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Process	The organized method of converting inputs (people, equipment, methods, materials, and environment), to outputs (products or services). The natural aggregation of work activities and tasks performed for program delivery.
Process Costing	A method of cost accounting that first collects costs by processes and then allocates the total costs of each process equally to each unit of output flowing through it during an accounting period.
Process Value Analysis	Tools and techniques for studying processes through customer value analysis. Its objective is to identify opportunities for lasting improvement in the performance of an organization. It provides an in-depth review of work activities and tasks, through activity analysis, which aggregate to form processes for agency program delivery. In addition to activity-based costing, quality and cycle time factors are studied for a complete analysis of performance measurement. Each activity within the process is analyzed, including whether or not the activity adds value for the customer.
Product	Any discrete, traceable, or measurable good or service provided to a customer. Often goods are referred to as tangible products, and services are referred to as intangible products. A good or service is the product of a process resulting from the consumption of resources.
Program Account	The budget account into which an appropriation to cover the subsidy cost of a direct loan or loan guarantee program is made and from which such cost is disbursed to the financing account. Usually, a separate amount for administrative expenses is also appropriated to the program account. (OMB <i>Circular A-11</i>)
Projected Unit Credit Actuarial Method	A method under which the projected benefits of each individual included in an actuarial present valuation are allocated by a consistent formula to valuation years. The actuarial present value of benefits allocated to the valuation year is called the normal cost. The actuarial present value of benefits allocated to all periods before a valuation year is called actuarial liability. (Actuarial Standard of Practice)

Projection	The term “projection” refers to prospective financial information, including but not limited to prospective financial statements, based on one or more hypothetical assumptions or sets of assumptions. The hypothetical assumptions relate to future conditions and actions that may occur, but which are not necessarily deemed probable (unlike the case with forecasts). Both forecasts and projections may contain a range.
Property, Detained	Property taken into custody temporarily for purposes of preserving the status quo (items in or around a crime scene) or to protect the government from liability for loss (luggage of an arrested traveler, vehicle of an arrested drunk driver), or determining Customs admissibility, with the intent to release the property as soon as it is no longer necessary to preserve the status quo or the owner can assume responsible custody. This action is not a seizure under the law and thus detained property is not considered seized property.
Property, Embargoed	Property that may be legal to possess or own in the U.S., but whose import/export is prohibited (e.g., Iranian carpets, Cuban cigars).
Property, Forfeited	Property of any type (currency, monetary interests, realty, intangible property, and tangible personal property) for which title has vested in the Federal government, over any other asserted legal interest in the property, by exercise of a legal forfeiture process.
Property, Plant, And Equipment, General	PP&E used to provide government services or goods. The cost of general PP&E is capitalized, i. e. recorded as assets on the balance sheet. For detailed characteristics of and accounting for general PP&E, see paragraphs 23 through 34, SFFAS No. 6.
Property, Prohibited	Property for which no private right of ownership is recognized under U.S. law, or of which mere private possession is prohibited under U.S. law. Examples include certain controlled substances, counterfeit currency, counterfeit monetary and financial instruments, and certain firearms. This property is a type of seized property.

Property, Seized

Property of any type (currency, monetary interests, realty, intangible property, and tangible personal property) over which the federal government has exercised its power under law to assert possession and control in opposition to any other party asserting a legal interest in the property.

Seized for evidence - Property the federal government has seized for the sole purpose of preserving and protecting the property for possible use in civil or criminal judicial proceeding. The expectation is that the property will be returned to its rightful owners upon conclusion of the judicial proceedings. However, circumstances can allow the status of property seized for evidence to change to property seized for forfeiture.

Seized for forfeiture - Property the federal government has seized for the purpose of transferring title to the federal government through exercise of a legal forfeiture process. This includes property seized for forfeiture that also may be used in an evidentiary proceeding.

Seized for tax purposes - Property the federal government has seized for the purpose of satisfying a tax liability to the federal government through exercise of a legal tax enforcement process. This includes property seized for tax purposes that also may be used in an evidentiary proceeding.

Seized for other purposes - Property the federal government has seized for purposes other than for evidence, for forfeiture, or for tax purposes. Examples of property in this category include seizures for satisfaction of debts owed the government, for protection of public safety or navigation (adrift vessel), and for preservation of environmental conditions (sinking vessel). This includes property seized for these other governmental purposes that also may be used in an evidentiary proceeding.

Proprietary Accounting

Also known as financial accounting, a process that supports accrual accounting and financial reporting that attempts to show actual financial position and results of operations by accounting for assets, liabilities, net position, revenues, and expenses. (See Tierney, Cornelius E., *Handbook of Federal Accounting Practices*, Reading Massachusetts: Addison-Wesley, 1982:122).

Purchases Method	A method of accounting for goods, such as materials and supplies, in which the acquisition cost is recognized as an expense upon purchase of the goods rather than upon their use.
Railroad Retirement Program	A federal program somewhat similar to Social Security, designed for workers in the railroad industry. The provisions of the Railroad Retirement Act provide for a system of coordination and financial interchange between the Railroad Retirement program and the Social Security program.
Reappropriation	Enacted legislation that continues the availability of unexpended funds that expired or would otherwise expire. (JFMIP Standardization Project)
Receipts	Collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment, and gifts of money to the Government.
Receiving Entity	An entity to which functions are transferred. (Technical Bulletin 2003-1)
Recognition (Or Recognize)	The term recognition bears the same meaning as used by the Financial Accounting Standards Board in its conceptual statements. Recognition is the process of formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, or the like. A recognized item is depicted in both words and numbers, with the amount included in the statement totals. Recognition comprehends both initial recognition of an item and recognition of subsequent changes in or removal of a previously recognized item. (Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 5, <i>A Replacement of FASB Concepts Statement No. 3</i> , para. 6.)
Recognize	To determine the amount, timing, classification, and other conditions precedent to the acceptance and entry of a transaction. Hence, to give expression on the books of account; said of transactions.

Record	To give expression to a transaction on (or in) the books of account; to enter.
Recourse	The rights of a holder in due course of a financial instrument (such as a loan) to force the endorser on the instrument to meet his or her legal obligations for making good the payment of the instrument if dishonored by the maker or acceptor. The holder in due course must have met the legal requirements of presentation and delivery of the instrument to the maker of a note or acceptor of a draft and must have found that this legal entity has refused to pay for or defaulted in payment of the instrument.
Reestimate	Refers to estimates of the subsidy costs performed subsequent to their initial estimates made at the time of a loan's disbursement.
Reimbursements	Sums received as payment or advance payment for goods or services furnished either to the public or to another federal government account. If authorized by law, these sums are credited directly to specific appropriation and fund accounts. These amounts are deducted from the total obligations incurred (and outlays) in determining net obligations (and outlays) for such accounts. (Budget Glossary) Reimbursements are offsetting collections. (See <i>offsetting collections</i> .)
Repairable	An inventory item that is expected to be repaired when broken or worn out.
Replacement Cost	The cost to reproduce an inventory item by purchase or manufacture. In lower of cost or market computations, the term "market" means replacement cost, subject to ceiling and floor limitations.
Required Supplementary Information (RSI)	RSI was added to the accounting literature by Statement of Financial Accounting Standards (SFAS) 25, <i>Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies</i> , published by the Financial Accounting Standards Board (FASB) in 1979. That Statement has been amended, but the RSI category continues to be used in a variety of standards published by the FASB, the Governmental Accounting Standards Board (GASB), and the FASAB. The auditor's responsibility for RSI is

discussed in section AU 558 of the codification of professional auditing standards published by AICPA. (SFFAS 25)

Required Supplementary Stewardship Information (RSSI)

(1) Information reported outside the principal financial statements that is an essential part of an entity's financial reporting; therefore the statement contains recommendations for its measurement and presentation. (2) The category defined by the Board for reporting information required by the stewardship standards. Stewardship information may be presented as RSSI, in the financial statements, or in the notes to them. Stewardship information will be necessary for a fair presentation of financial position and results of operations.

Research And Development

Federal investment in research and development refers to those expenses incurred in support of the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of basic research, applied research, and development.

Responsibility Segment

A significant organizational, operational, functional, or process component which has the following characteristics: (a) its manager reports to the entity's top management; (b) it is responsible for carrying out a mission, performing a line of activities or services, or producing one or a group of products; and (c) for financial reporting and cost management purposes, its resources and results of operations can be clearly distinguished, physically and operationally, from those of other segments of the entity.

Responsibility Center

An organizational unit headed by a manager or a group of managers who are responsible for its activities. Responsibility centers can be measured as revenue centers (accountable for revenue/sales only), cost centers (accountable for costs/expenses only), profit centers (accountable for revenues and costs), or investment centers (accountable for investments, revenues, and costs).

Restatement (Of Direct Loans Or Loan Guarantees)	Refers to establishing a new book value of a direct loan or the liability of a loan guarantee.
Revenue Adjustment	A contra revenue account that is used to report reduction in revenue when realization is not probable (less likely than not). It includes, returns, allowances, and price redeterminations but not credit losses (due to the inability of the debtor to pay the established or negotiated price).
Revolving Fund	A fund consisting of permanent appropriation and expenditures of collections, from both the public and other Governmental agencies and accounts, that are earmarked to finance a continuing cycle of business-type operations. (OMB <i>Circular A-34</i>)
Risk Category	Subdivisions of a cohort of direct loans or loan guarantees into groups of loans that are relatively homogeneous in cost, given the facts known at the time of obligation or commitment. Risk categories will group all loans obligated or committed for a program during the fiscal year that share characteristics predictive of defaults and other costs. (OMB <i>Circular A-11</i>)
Seizing Agency	The agency that seizes property as a part of its law enforcement activities.
Selling Expense (Cost)	Expenses incurred in selling or marketing, e.g., salaries, commissions, and promotion expenses.
Sensitive Items	Items that could be a hazard or threat to public safety or the economy in Federal custody that would cause discredit or embarrassment to the Federal government if it lost accountability over those items.
Service	An intangible product or task rendered directly to a customer.

Social Security Act	The Social Security Act governs most operations of the Social Security program. The original Social Security Act is Public Law 74-271, enacted August 14, 1935. With subsequent amendments, the Social Security Act consists of 20 titles, of which four have been repealed. The OASDI program is authorized by Title II of the Social Security Act.
Social Insurance Programs	Income transfer programs financed by compulsory earmarked taxes and also, in certain cases, general revenues of the federal government. (Also see <i>separate definition of insurance and guarantees</i>).
Special Fund	Federal fund accounts for receipts earmarked for specific purposes and the associated expenditure of those receipts. (OMB, <i>The Budget System and Concepts</i>)
Specific Identification	An inventory system in which the seller identifies which specific items are sold and which remain in ending inventory.
Spreadsheets	Computer code, often a collection of programs, used to make calculations (e.g., cash flow estimates) according to the proposed models and assumptions. Spreadsheets are not models although the term “spreadsheet model” is sometimes used.
Standard Costing	A costing method that attaches costs to cost objects based on reasonable estimates or cost studies and by means of budgeted rates rather than according to actual costs incurred. The anticipated cost of producing a unit of output. A predetermined cost to be assigned to products produced. Standard cost implies a norm, or what costs should be. Standard costing may be based on either absorption or direct costing principles, and may apply either to all or some cost elements.
Standard Costs	Predetermined expected unit costs, which are acceptable for financial reporting purposes if adjusted periodically to reflect actual results.

State And Local Governments	State and local governments generally include: the 50 States and the District of Columbia; cities, counties, townships, school districts, special districts, public authorities, and other local governmental units as defined by the Bureau of the Census; and Puerto Rico, the Virgin Islands, and other US territories.
Stewardship	The Federal Government's responsibility for the general welfare of the nation in perpetuity.
Stewardship Investments	Items recognized as expense in calculating net cost, but meriting special treatment to highlight the substantial investment and long-term benefit of the expenses. This would include nonfederal physical property, human capital, and research and development.
Stewardship Land	Land and land rights owned by the Federal Government that are not acquired for or in connection with items of general PP&E.
Stewardship Responsibilities	The projected financial impact on the Government of sustaining the current services that it provides pursuant to laws already enacted. The commitments and constraints reflected in "current services" are inherent in the tax and spending policies contained in current law.
Subsidy Cost	The cost of a grant of financial aid, usually by a governmental body, to some person or institution for particular purposes. Credit subsidy cost is the estimated long-term cost to the government of direct loans or loan guarantees calculated on a net present value basis, excluding administrative costs. (Adapted from OMB <i>Circular A-11</i>) Direct loan subsidy cost is the estimated long-term cost to the government of direct loans calculated on a present value basis, excluding administrative costs. The cost is the present value of estimated net cash outflows at the time the direct loans are disbursed. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the loan, applicable to the time when the loans are disbursed. (Adapted from OMB <i>Circular A-11</i>) Loan guarantee subsidy cost is the estimated long-term cost to the government of loan guarantees calculated on a present value basis, excluding administrative costs. The cost is the

present value of estimated net cash outflows at the time the guaranteed loans are disbursed by the lender. The discount rate used for the calculation is the average interest rate (yield) on marketable Treasury securities of similar maturity to the loan guarantees, applicable to the time when the guaranteed loans are disbursed. (Adapted from OMB *Circular A-11*)

Support Costs Costs of activities not directly associated with production. Typical examples are the costs of automation support, communications, postage, process engineering, and purchasing.

Tax Expenditure A revenue foregone attributable to a provision of the federal tax laws that allows a special exclusion, exemption, or deduction from gross income or provides a special credit, preferential tax rate, or deferral of tax liability. (GAO *Budget Glossary*)

Tax Gap An estimate of taxes (including duties) that are unpaid because of noncompliance with existing laws and regulations.

Taxable Payroll Taxable wages and taxable self-employment income. When multiplied by the combined employee-employer tax rate, it yields the total amount of taxes incurred by employees, employers, and the self-employed for work during the period.

Terminal Dividends Dividends to policyholders calculated and paid upon termination of a contract, such as on death, surrender, or maturity. If the payment of terminal dividends is probable and the amount can be reasonably estimated, the liability should be recognized. AICPA Statement of Position 95-1.

Title The right to property; the means by which such right is established.

Total Cost Method An accounting method that includes the actual acquisition cost of each item held plus the costs of any additions, improvements, alterations, rehabilitations, or replacements that extend the useful life of an asset.

Traceability	The ability to assign a cost directly to a specific activity or cost object by identifying or observing specific resources consumed by the activity or cost object.
Transaction	A particular kind of external event involving the transfer of something of value concerning two or more entities. The transfer may be a two way or one way flow of resources or of promises to provide resources. (Adapted from Financial Accounting Standards Board, <i>Statement of Financial Accounting Concepts No. 6</i> , Elements of Financial Statements)
Transferred Entity	An entity preparing stand-alone financial statements consolidated with a legacy entity's financial statements prior to transfer and with a receiving entity's financial statements after transfer. (Technical Bulletin 2003-1)
Transfers Between Appropriation/Fund Accounts	Occur when all or part of the budget authority in one account is transferred to another account when such transfers are specifically authorized by law. The nature of the transfer determines whether the transaction is treated as an expenditure transfer or a non- expenditure transfer. (JFMIP Standardization Project)
Treasury Warrant	An official document that the Secretary of the Treasury issues pursuant to law and that establishes the amount of monies authorized to be withdrawn from the central accounts that Treasury maintains. Warrants for currently unavailable special and trust fund receipts are issued when requirements for their availability have been met. (GAO <i>Budget Glossary</i>)
Trust Funds	The term "trust funds" is often colloquially used to refer to Trust Fund Accounts (see definition below). Although earmarked monies are predominantly in funds that are designated by law as trust funds, the meaning of the term "trust" in the Federal Government differs significantly from its meaning in the private sector. Whereas earmarked funds in the Federal Government are distinct from fiduciary activities, a trust in the private sector necessarily involves a fiduciary relationship. An earmarked fund should not be characterized as a "trust" in general purpose external financial reports of Federal entities. (The use of the term "trust fund" is acceptable only in the fund's official title.)

Trust Fund Accounts Accounts that are designated by law as trust funds, for receipts earmarked for specific purposes and the associated expenditure of those receipts. Collections may come from the public (e.g., earmarked taxes or user charges) or from intra-budgetary transfers. More than 150 Federal Government trust funds exist, of which the largest and best known finance several major benefit programs (including Social Security and Medicare) and certain infrastructure spending (the Highway and the Airport and Airway trust funds).

Trust Revolving Funds Accounts that record permanent appropriation and expenditure of collections used to carry out a cycle of business type operations in accordance with a statute that designates the fund as a trust fund. (OMB *Circular A-34*)

Trustees, Boards Of, OASDI And Medicare Boards established by the Social Security Act to oversee the financial operations of the Old-Age, Survivors, and Disability Insurance (“Social Security” or OASDI), the Hospital Insurance (HI), and the Supplementary Medical Insurance (SMI) trust funds. The Boards are composed of six members, four of whom serve automatically by virtue of their positions in the Federal Government: the Secretaries of Treasury (the managing trustee), Labor, and Health and Human Services and the Commissioner of Social Security (since March 1995). The other two members are appointed by the President and confirmed by the Senate to serve as public representatives to serve 4 year terms.

Uncontrollable Cost The cost over which a responsible manager has no influence.

Unemployment Insurance (UI) The UI program was created in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. The UI program is administered through a unique system of federal-state partnerships, established in federal law but executed by state officials through conforming state laws. The Federal Government provides broad policy guidance and program direction through the oversight of the U.S. Department of Labor. The UI program is financed by federal and state unemployment taxes. Federal unemployment taxes are used to pay for the UI administrative costs, to pay the federal share of extended UI benefits, and to maintain a loan account from which states may borrow to pay UI benefits. State UI taxes are used exclusively for the payment of regular UI

benefits and the state's share of extended benefits. In addition to the federal tax, individual states finance their UI programs through state tax contributions from subject employers on the wages of covered employees. (Three states also collect contributions from employees.) Within federal guidelines, state tax rates are assigned in accordance with an employer's experience with unemployment. Actual tax rates vary greatly among the states.

Unit Cost The cost of a selected unit of a good or service. Examples include dollar cost per ton, machine hour, labor hour, or department hour.

Unobligated Balances Balances of budgetary resources that have not yet been obligated. (JFMIP Standardization Project) Unobligated balances expire (cease to be available for obligation) for:—1-year accounts at the end of the fiscal year;—multiple-year accounts at the end of the period specified;—no-year accounts only when they are 1) rescinded by law, 2) purpose is accomplished, or 3) when disbursements against the appropriation have not been made for 2 full consecutive years. (GAO *Budget Glossary*).

Useful Life The normal operating life in terms of utility to the owner.

Valuation Account (Allowance Or Reserve) An account that partly or wholly offsets one or more other accounts; for example, accumulated depreciation is a valuation account related to specific depreciable assets and allowance for bad debts is a valuation account related to accounts receivable. If a valuation account is deducted from the related asset or liability it is sometimes referred to as a contra-asset or contra-liability account.

Valuation (Or Accounting Valuation) Valuation methods and bases are numerous and varied; and may be expressed quantitatively and in monetary terms. Application may be made to a single asset, a group of assets, or an entire enterprise, as determined by various bases and methods.

Value-added Activity An activity that is judged to contribute to customer value or satisfy an organizational need. The attribute "value-added" reflects a belief that the

activity cannot be eliminated without reducing the quantity, responsiveness, or quality of output required by a customer or organization. Value-added activities should physically change the product or service in a manner that meets customer expectations.

Variable Cost A cost that varies with changes in the level of an activity, when other factors are held constant. The cost of material handling to an activity, for example, varies according to the number of material deliveries and pickups to and from that activity.

Variable Value Securities Securities that have unknown redemption or maturity values at the time of issue. Values of these securities can vary on the basis of regulation or specific language in the offering.

Variance (1) The amount, rate, extent, or degree of change, or the divergence from a desired characteristic or state. (2) The difference for a year or less between the elements (direct material, direct labor, factory overhead) of standard cost and actual cost. The term applies to (a) a money difference or (b) changes in the character or purpose of amounts expended.

Weighted-average A periodic inventory costing method where ending inventory and cost of goods sold are priced at the weighted-average cost of all items available for sale.

Whole Life Policies Policies that provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of the insured.

Write-off An action to remove an amount from an entity's assets. A write-off of a loan occurs when an agency official determines, after all appropriate collection tools have been used, that a debt is uncollectible. Active collection on an account ceases, and the account is removed from an entity's receivables. (*Treasury Financial Manual Supplement*)

Appendix F: Consolidated List of Abbreviations

AAPC	Accounting and Auditing Policy Committee
ABA	American Bar Association
AEAN	aggregate entry age normal
AFDC	Aid to Families with Dependent Children
AICPA	American Institute of Certified Public Accountants
ANPV	actuarial net present value
APB	Accounting Principles Board
APV	actuarial present value
ARB	Accounting Research Bulletin
AU	Auditing Standards
CBO	Congressional Budget Office
CCC	Commodity Credit Corporation
CERCLA	Comprehensive Environmental Response Compensation and Liability Act of 1980
CFO Act	Chief Financial Officers Act
CFS	consolidated financial statements
COLA	cost of living adjustment
CPI	Consumer Price Index
CSRS	Civil Service Retirement System
D&D	decontamination and decommissioning
DI	Disability Insurance
DoD	Department of Defense
DOL	U.S. Department of Labor
DOJ	Department of Justice
ED	exposure draft
EDP	electronic data processing
EPA	Environmental Protection Agency
ESAA	Employment Security Administration Account
EUCA	Extended Unemployment Compensation Account
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FECA	Federal Employees Compensation Account
FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement Plan
FIFO	first-in, first-out
FMFIA	Federal Manager's Financial Integrity Act
FTCA	Federal Tort Claims Act
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act
GAAP	generally accepted accounting principles
GAO	Government Accountability Office
GDP	Gross Domestic Product

List of Abbreviations

GLTDAG	General Long-Term Debt Account Group
GPFFR	general purpose federal financial report
GPFS	general-purpose financial statements
GPRA	Government Performance and Results Act
GSE	government sponsored enterprises
HI	Hospital Insurance (Medicare)
IBNR	incurred but not reported
JFMIP	Joint Financial Management Improvement Program
LAC	latest acquisition cost
LCM	lower of cost or market
LIFO	last-in, first-out cost flow
MD&A	management's discussion & analysis
MRS	Military Retirement System
NCGAS	National Council on Government Accounting Statement
NIPA	national income and product accounts
NPR	National Performance Review
NPV	net present value
O&M	operation and maintenance
OASDI	Old-Age, Survivors, and Disability Insurance
OASI	Old-Age and Survivors Insurance
OMB	Office of Management and Budget
ORB	other retirement benefits
OPEB	Other postemployment benefits
PBGC	Pension Benefit Guaranty Corporation
PRP	potentially responsible parties
PSA	Personal Security Accounts
PUC	projected unit credit
PV	present value
RCRA	Resource Conservation and Recovery Act)
RI/FS	remedial investigation/feasibility study
RSI	required supplementary information
RSSI	required supplementary stewardship information
SAS	Statement of Auditing Standards
SEC	Securities Exchange Commission
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SGL	Standard General Ledger
SMI	Supplementary Medical Insurance (Medicare)
SNA	System of National Accounts
SOP	Statement of Position
SSA	Social Security Administration

List of Abbreviations

UI	Unemployment Insurance
UTF	Unemployment Trust Fund
VA	Veterans Affairs